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Our ref

Your ref

Date

-

29 July 2016

Dear Olivia,

### **Application for Derogation from Common Connection Charging Methodology**

I am writing on behalf of Western Power Distribution (West Midlands) plc ("WPD").

In response to Ofgem's call for DNOs to undertake trials to facilitate quicker and more efficient connections in their publication of September 2015, WPD proposes to undertake a trial under which the High Cost Cap in paragraph 5.15 of the Statement of Methodology and Charges for Connection to Western Power Distribution's Electricity Distribution System<sup>1</sup> will be disapplied, so that when a group of customers apply for DG connections within a set time period and the aggregate capacity sought by those customers exceeds a pre-defined minimum capacity, the reinforcement costs will be shared between those customers in proportion to the capacity in their connection offer (rather than being charged to the first customer that triggers the High Cost Cap).

This trial will require WPD to provide connection offers that are not wholly in accordance with the Common Connection Charging Methodology (the "CCCM"), compliance with which is a requirement of Standard Condition 13.1 of the electricity distribution licence. Accordingly, I hereby request the necessary consent to run this trial and a derogation from the CCCM. Detailed particulars of the derogation are set out in the request attached to this letter.

Yours sincerely,



ALISON SLEIGHTHOLM  
Regulatory & Government Affairs Manager

<sup>1</sup> <https://www.westernpower.co.uk/docs/connections/Charging-Statements/Connections-West-Midlands-Nov-2014-doc.aspx>

*Western Power Distribution (South Wales) plc, Registered in England and Wales No. 2366985*

*Western Power Distribution (South West) plc, Registered in England and Wales No. 2366894*

*Western Power Distribution (East Midlands) plc, Registered in England and Wales No. 2366923*

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*Registered Office: Avonbank, Feeder Road, Bristol BS2 0TB*

## Request For Ofgem Consent

Reference:	Aggregate DG Capacity Trial
Date Requested:	29 July 2016
Licence Condition:	Standard Licence Conditions 13.1 and 14.15
Licensee:	Western Power Distribution (West Midlands) plc
Description of consent requested:	Consent for the provision of connection offers not wholly compliant with WPD's Connection Charging Methodology and derogation from section 5 paragraph 5.15 of the Common Connection Charging Methodology therein.
Form of the derogation:	Derogation from compliance with Common Connection Charging Methodology for a relevant section of WPD's Network for six years.
WPD Contact:	Richard Allcock, Connections Policy Engineer
Email:	rallcock@westernpower.co.uk
Telephone:	01332 827503

### 1. Description of the non-compliance

#### Proposed non-compliance

- 1.1 Western Power Distribution (West Midlands) plc ("**WPD**") requests a derogation from the licence obligations in Standard Conditions 13.1 and 14.15 of its Electricity Distribution Licence. The derogation is requested in order to permit WPD to proceed in a way which does not comply with WPD's Connection Charging Methodology and to enter into arrangements for the purposes of providing or modifying connections in which the charges to be levied do not comply with the Connection Charging Statement, as required in Standard Conditions 13.1 and 14.15. This will allow WPD to conduct the trial described in this request. .
- 1.2 Section 5 (*Common Connection Charging Methodology*) of the Connection Charging Methodology sets out the method for calculating a customer's connection charge. It splits that connection charge into three categories:
  - (a) costs paid in full by the Customer;
  - (b) costs apportioned between a DNO and the Customer; and
  - (c) costs paid by the Customer in respect of works that have previously been constructed (or are committed) and are used to provide the new connection.
- 1.3 Paragraph 5.15 of that section states that: "*For generation connections only, reinforcement costs in excess of the high-cost project threshold of £200/kW shall be charged to you [i.e. the Customer] in full as a Connection Charge.*" This rule is known as the "£200 per kW rule" or the High Cost Cap (the "**HCC**") and it applies to the first customer that accepts a connection offer that triggers the HCC on the relevant section of WPD's network.
- 1.4 WPD seeks to run a trial under which the HCC will be disapplied, so that when a group of customers apply for distributed generation ("**DG**") connections within a set time period and the aggregate capacity sought by those customers exceeds a pre-defined minimum capacity (that

is, where the cost of the required reinforcement is less than £200 per kW), the reinforcement costs will be shared between those customers in proportion to the capacity in their connection offer (rather than being charged to the first customer that triggers the HCC).

#### Proposed trial

- 1.5 The trial will apply to a group of customers who have each applied to WPD for a DG connection on the same section of network and whose connection charge calculation triggers the HCC.
- 1.6 WPD will issue a notice under which the DG customer can select either:
- (a) a new or revised connection offer under section 16 of the Electricity Act 1989 (a "**section 16 connection offer**"). This will include the HCC costs; or
  - (b) an alternative "aggregate capacity" offer under section 22 of the Electricity Act 1989 (a "**section 22 connection offer**").

The section 22 connection offer and section 16 connection offer are mutually exclusive, and by accepting the terms of the section 22 connection offer, the section 16 connection offer falls away.

- 1.7 The section 22 connection offer will contain the same information as a section 16 connection offer, including the same connection charge (the "**HCC Connection Charge**") but will also include additional provisions that will only apply if enough customers accept section 22 connection offers with a combined aggregate capacity high enough to not trigger the HCC (the "**Minimum Capacity**".) If the Minimum Capacity is reached, the part of the connection charge relating to reinforcement costs will be recalculated and apportioned between each of the DG customers.
- 1.8 On accepting the section 22 connection offer, the DG customer has two options:
- (a) to proceed on the basis of the HCC Connection Charge; or
  - (b) to suspend their connection scheme until the Minimum Capacity is reached.

In the section 22 connection offer there will be validity and delivery milestones which are a limiting factor to prevent the 'capacity' being reserved indefinitely. A customer cannot reserve capacity without making progress against milestones such as planning permission. WPD would also include a longstop date. If the Minimum Capacity is not reached by the longstop date, any customers who have accepted their section 22 connection offers must continue on the basis of the HCC Connection Charge or their offer will be terminated.

- 1.9 Prior to the longstop date, the DG customer can choose to proceed on the basis of the HCC Connection Charge as far along the process as it wishes in the hope that the Minimum Capacity will be reached before any reinforcement works are carried out. However, if the Minimum Capacity is not met and the DG customer chooses not to proceed, the DG customer will remain liable for any costs already incurred by WPD.
- 1.10 The intention is to allow DG customers to wait as long as required after issuing the first section 22 connection offer for the Minimum Capacity to be reached (subject to the longstop date). DG customers would need to balance their costs and risk on whether they choose to wait for further acceptances of section 22 connection offers and delay their projects or whether to proceed on the basis of the HCC Charge.
- 1.11 If at any time the Minimum Capacity is reached, WPD will issue each DG customer with a notice specifying:

- (a) its recalculated connection charge;
  - (b) the amount it would be required to pay under an indemnity if it cancels its connection offer (the indemnity covers the proportion of the DG customer's reinforcement costs outstanding prior to completion of the reinforcement works); and
  - (c) the process for accepting the recalculated charges.
- 1.12 All affected schemes will be suspended for a fixed period of time (e.g. 10 working days from the date of the notice). If a DG customer is happy to proceed on the basis of the recalculated charge and indemnity, it does nothing. If a DG customer wishes to withdraw from the scheme, it must provide written notice to WPD within the 10 working day period. If a DG customer chooses to withdraw, its connection offer is automatically terminated and it will not be entitled to a refund of any payments made to date. This is to avoid customers agreeing to the process but pulling out at the indemnity stage in the hope that the other customers will proceed and pick up the higher costs of reinforcement works. If a DG customer does not notify WPD of its intention to withdraw within the 10 working day period, it will be liable under the indemnity if the connection is cancelled.
- 1.13 If a sufficient number of customers proceed – the section 22 connection offers continue on the basis of the recalculated costs and indemnities. If the Minimum Capacity is not met by customers who have accepted the recalculated costs and indemnity, each customer may either choose to proceed on the basis of the HCC Connection Charge (in the hope that another customer will join the scheme and the Minimum Capacity will be met) or wait until either the Minimum Capacity or longstop date is reached.

#### Scope of the derogation requested

- 1.14 WPD requests the derogation on a section of its network where it has identified a number of DG schemes triggering reinforcement. Each DG scheme triggers the HCC individually, but the total capacity of each scheme would not do so if taken together. The derogation should apply to these DG schemes and to any potential new DG schemes where the relevant DG customers sign up to the section 22 connection offer terms described above.
- 1.15 It is requested that the derogation applies such that if the Minimum Capacity has been met by DG customers accepting section 22 connection offers, any DG customers with accepted section 16 connection offers cannot then benefit from the disapplication of the HCC. The DG customers with section 16 connection offers would still be subject to the HCC in respect of their connections, this would mitigate the risk of the trial not proceeding and the indemnity not being in place for the section 16 connection offers.,

## **2. Reason for the non-compliance**

- 2.1 The derogation and trial are intended to provide a fairer apportionment of costs between DG customers requiring capacity on the same part of WPD's network. The trial is designed to expand the options available to DG customers seeking connections, as follows:
- (a) it offers an alternative method to charging for DG-triggered reinforcement in which the costs are shared between DG customers;
  - (b) if a customer cannot proceed on the basis of the HCC Connection Charge, the customer now has the option of waiting (and not incurring any costs) until the Minimum Capacity is reached; and

- (c) if a customer does not want to wait for the Minimum Capacity to be reached, it can proceed on the basis of the HCC Connection Charge and provided the Minimum Capacity is reached prior to the reinforcement works commencing, the connection charge will be recalculated (and will likely be significantly lower).
- 2.2 As mentioned, the HCC requires the first DG customer applying for a connection offer to pay the full costs in excess of £200/kW where that connection offer triggers reinforcement works above the threshold. Subsequent DG customers connecting to the reinforced assets are not required to contribute to the cost in excess of the HCC and the initial DG customer may not be entitled to a refund from those customers under the Electricity (Connection Charges) Regulation (2002).
- 2.3 Where multiple DG customers apply for connections within a similar time period, an element of luck will determine which customer applies for a connection offer first and is charged the costs over the HCC. The timing of the application may not track through to the moment the connection is energised because of the factors influencing the time taken to connect a DG scheme (such as receipt of planning permissions and fulfilment of other conditions precedent). This means that the DG customer required to pay the cost in excess of the HCC may not be the one that connects first. The arbitrary outcome coupled with the level of reinforcement costs can deter DG customers from seeking connections to WPD's network by creating a barrier that is too high for the DG customer to overcome.
- 2.4 The HCC is appropriate where a single DG customer can only be connected following large reinforcement investment on a part of the network where there is a low chance of the surplus new capacity being used by other DG customers in the short to medium-term. However, where that new capacity will be used by subsequent DG customers who have applied for and accepted a connection offer, WPD believes it is appropriate to share the reinforcement costs between the DG customers.
- 2.5 WPD therefore seeks a derogation in order to run a trial to apply an alternative method to charging for reinforcement in which an aggregated capacity of DG customers are considered together so as not to trigger the HCC.
3. **Duration of the derogation**
- 3.1 It is requested that the derogation is granted for a period of six years. This will allow WPD to make section 22 connection offers for multiple connections and ensure that there is an opportunity to reach the Minimum Capacity. It will also provide a suitable period of time in which complications with the interaction between the HCC and the funding provisions in the Electricity (Connection Charges) Regulations 2002 (the "ECCRs") can be avoided. The derogation period also ensures that WPD can re-offer the capacity to subsequent customers should accepted connection schemes cancel and release some of the capacity created by the reinforcement.
4. **Impact of the non-compliance**
- Consumers
- 4.1 The HCC acts as a deterrent to DG customers who would otherwise proceed with a connection to WPD's network because it renders the cost of a connection uneconomic. Therefore WPD expects the non-compliance to have a positive impact on these consumers by facilitating more connections to the network.
- 4.2 For the wider consumer base, the impact of removing the HCC is that WPD has to contribute more towards the reinforcement. However, the trial is intended to replicate the charging methodology applicable to a single large customer for a group of smaller customers with an

equivalent or greater aggregate capacity. Accordingly, in this scenario the cost to consumers is the same.

#### Security of Supply

- 4.3 Not applicable.

#### Competition

- 4.4 It is not anticipated that the non-compliance will distort competition in the electricity market. In fact, it is hoped that the trial will increase the number of DG customers able to compete in this market. The non-compliance may therefore also increase opportunities for the construction of sole use connection assets by independent connection providers (i.e. the non-compliance should lead to more contestable works ).

#### Sustainable Development

- 4.5 The non-compliance will help to increase connections of renewable energy

#### Health and Safety

- 4.6 The health and safety risks of any DG connection, whether in the context of the trial or otherwise, are assessed in line with applicable health and safety law and regulations in the usual way. No additional or unusual health and safety impact is anticipated as a result of the proposed non-compliance.

#### Other affected parties

- 4.7 The derogation will ensure that 'normal' cost apportionment can be applied to reinforcement works and that the HCC is not triggered by DG customers. This will benefit all DG customers participating in the trial and any subsequent wider application.

### **5. Actions to mitigate the risks**

#### Risks mitigated by the trial itself

- 5.1 To mitigate the risk of aggregate capacity connections not being taken up and customers triggering the HCC in circumstances where this is not appropriate, WPD will run a trial on a section of its network where it is aware that multiple connection applications will be made within the requisite time period, and where the aggregate capacity of those connection applications is likely to reach the Minimum Capacity.

#### Risks mitigated within the trial

- 5.2 In order to prevent 'capacity' being reserved indefinitely, the trial will include a longstop date. If the Minimum Capacity is not reached by the longstop date, any DG customers who have accepted their section 22 connection offers must either continue on the basis of the HCC Connection Charge or accept that their offers will be terminated.
- 5.3 Existing milestones in the connection offers for obtaining planning permission, commencing works, completing works and connecting will ensure that only schemes which are progressing to connection and energisation are able to benefit. This will decrease the chance of stranded or underutilised assets and ensure the trial is genuinely effective. It will also protect against developers holding on to the capacity and not progressing their scheme.
- 5.4 Once the Minimum Capacity is reached, each DG customer must enter into an indemnity to cover its proportion of the reinforcement costs should that DG customer cancel its connection

before the works are complete. The indemnity mitigates the risk of the remaining DG customers having to meet the costs of the cancelling DG customer. The indemnity also ensures that, during the period in which the derogation applies, and the HCC is therefore disappplied, WPD is not left with liability for the costs of DG customers who cancel under this trial.

- 5.5 If a DG customer chooses to cancel upon reaching the Minimum Capacity, its connection offer is automatically terminated and it will not be entitled to a refund of any payments made to date. This mitigates the risk of customers agreeing to the process but pulling out at the indemnity stage in the hope that the other customers will proceed and pick up the higher costs of reinforcement works.

## 6. **Proposals for restoring compliance**

If the trial is successful, it is proposed that the CCCM is amended so that aggregate capacity offers can be made in compliance with Standard Condition 13.1 of the Electricity Distribution Licence. If the trial is not successful, WPD proposes to revert to the status quo ante but will monitor the position in the ECCRs in relation to the problem in which a single DG customer is required to pay for reinforcement works (and where subsequent DG customers then benefit without paying).

## 7. **Alternative action**

Due to the lack of flexibility in the way in which the HCC currently operates, WPD does not see any alternative that avoids the HCC remaining a barrier where a number of small DG customers trigger network reinforcement above the HCC threshold.

## 8. **Additional information**

WPD has tried to take into account any likely variables and other considerations for the proposed trial. However, the nature of a trial is that it must be capable of being adapted or changed should unforeseen circumstances arise. The following additional information is based on recent correspondence with Ofgem and is intended to give more detail on how the trial might work in practice. WPD confirms that the trial will at all times be conducted in compliance with any derogation granted.

*Would the DG customers be required to provide security for the full amount on acceptance of the section 22 connection offer – or just a portion of the total connection charges? How would this differ from the current approach?*

- 8.1 On acceptance of the section 22 connection offer, the DG customer would be signing up to the principle of the indemnity. If the Minimum Capacity is reached, each DG customer would need to provide an indemnity for its full contribution towards the reinforcement costs (i.e. its apportioned amount based on its required capacity). DG customers would not need to provide the full payment for this upfront unless the works were underway or they wanted WPD to commence the reinforcement immediately.
- 8.2 The main difference to the current approach is the use of the indemnity, which requires a DG customer who cancels a scheme to pay for costs which may not have been incurred at the time the scheme was cancelled. Under the current approach, if a DG customer cancels a scheme they may not be required to pay for costs that have not been incurred at the time of cancellation. The trial treats the DG customers as having collectively triggered the reinforcement and the removal of the HCC. Therefore if a DG customer drops out this could jeopardise other DG customers' offers because WPD does not believe it could continue to disapply the HCC for a particular reinforcement scheme if the accepted export capacity falls below the HCC threshold and the apportioned costs are not covered by the indemnity.

How would the trial address situations where only some DG customers accepted section 22 connection offers, while others accept their section 16 connection offers?

- 8.3 If the Minimum Capacity is not met, the trial methodology could not be applied since the indemnities would not cover the cost of the reinforcement works. The risk a DG customer takes in accepting a section 22 connection offer is that the Minimum Capacity may not be met before the longstop date and the DG customer will either have to proceed on the basis of the HCC Connection Charge, or the offer will be terminated.
- 8.4 If the Minimum Capacity has been met by DG customers accepting section 22 connection offers, those DG customers with accepted section 16 offers would not be able to benefit from the disapplication of the HCC under the derogation. To mitigate the risk of the trial not proceeding, and the indemnity not being in place in their offers, the DG customers with section 16 connection offers would still be subject to the HCC in respect of their connections.
- 8.5 The trial does not address how to reimburse a first DG customer who, whether under the trial or under the current process, ends up funding all the costs over the threshold. It is hoped that the trial will mean this becomes a less frequent occurrence.

Could a customer with a section 22 connection offer subsequently request a section 16 offer?

- 8.6 On accepting a section 22 connection offer, the DG customer is agreeing that if the Minimum Capacity is reached it will provide an indemnity for its share of the reinforcement costs. As this amount cannot be confirmed at the time the section 22 connection offer is accepted (it will be calculated once the Minimum Capacity is reached) WPD will allow DG customers to withdraw during the 10 working day period after the Minimum Capacity is reached, and without incurring any liability under the indemnity.
- 8.7 However, for the trial to be successful DG customers that accept section 22 connection offers need to have agreed to the indemnity in principle. If a DG customer who does not withdraw during the 10 working day period after the Minimum Capacity is reached later cancels its section 22 connection offer it would be liable for the costs under the indemnity. This would not prevent the DG customer from applying for a new section 16 connection offer (although the DG customer would be liable for costs under the indemnity and the connection charge under the new section 16 connection offer).