

# **Guidance on third party access charges for licence exempt electricity distribution networks in Northern Ireland**

3 June 2013



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## 1 INTRODUCTION

- 1.1 The EU Third Energy Package of legislation (also referred to as IME3) relates to the creation of an EU Internal Market in Energy. It is a major package of EU legislation comprising three EU Regulations and two EU Directives. The Third Energy Package introduced a number of measures intended to protect consumers and reinforce energy retail market competition. These include the imposition of certain obligations on electricity distributors and suppliers.
- 1.2 The Gas and Electricity (Internal Markets) Regulations (Northern Ireland) 2011 (IME3 Regulations) implement the majority of the IME3 requirements of the Directives in Northern Ireland and came into operation on 15th April 2011<sup>1</sup>.
- 1.3 IME3 Regulations 17 and 19 amended Articles 8 and 10 of the Electricity Order to prohibit the activity of unauthorised electricity distribution and to provide for the Utility Regulator to grant licences authorising electricity distribution. The prohibition on unauthorised electricity distribution came into effect on 30 April 2013<sup>2</sup>.
- 1.4 In preparation for this, DETI published guidance<sup>3</sup> on the imposition of obligations on licence exempt distributors and suppliers. This guidance includes a requirement where if a use of system charge is to be imposed (following a request for Third Party Access), distribution exemption holders will be required to submit a statement of charges to the Utility Regulator for approval.
- 1.5 The guidance notes that the Utility Regulator will produce separate guidance on the charging principles that it will apply to assess the new charging methodologies.
- 1.6 This paper details the methodology and process we will use in assessing any submissions from exempt distribution network operators including the content of these methodologies and the process we will use to approve the charging methodologies.
- 1.7 It also covers the process for dealing with and disputes in relation to connections to an exempt distribution network operator.

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<sup>1</sup> See Appendix 4 - Associated documents

<sup>2</sup>[http://www.uregni.gov.uk/news/electricity\\_distribution\\_new\\_statutory\\_requirements\\_applicable\\_from\\_30\\_apri](http://www.uregni.gov.uk/news/electricity_distribution_new_statutory_requirements_applicable_from_30_apri)

<sup>3</sup> See Appendix 4 - Associated documents

1.8 Ofgem completed a similar exercise and produced guidance covering GB. We have reviewed the Ofgem guidance<sup>4</sup> and adopted the approach used by Ofgem where appropriate for Northern Ireland.

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<sup>4</sup> [Guidance on third party access charges for licence exempt gas and electricity distribution networks, 20 December 2010 \(ref:166/10\)](#)

## 2 LEGAL BACKGROUND

### Requirements of Directives

- 2.1 Article 32 of IME3 requires that a system of third party access to the distribution system be based on approved methodologies, applicable to all eligible customers and applied objectively and without discrimination between system users. Other articles applicable to network charging are Articles 28, 31, and 37 of IME3.
- 2.2 Third party access to energy infrastructure can be categorised as either:
- customers being able to use a system that they do not own or control in order to transport gas or electricity purchased for their own use or for resale, or
  - suppliers being able to use a system that they do not own or control in order to transport gas or electricity for sale to customers.
- 2.3 Article 32 of IME3 (Duties and powers of the regulatory authority) require that all methodologies for network charging are approved by the National Regulatory Authority (for Northern Ireland this is the Utility Regulator).
- 2.4 Electricity licence exemptions in NI were already provided for generation and supply under the Electricity (Class Exemptions from the Requirement for a Licence) Order (Northern Ireland) 1999 (former CEO).
- 2.5 Following consultation DETI has now introduced a new class exemptions order, the Electricity (Class Exemptions from the Requirement for a Licence) Order (Northern Ireland) 2013 (CEO).
- 2.6 The new CEO replaces the former CEO, provides for class exemptions for certain distributors and also imposes the obligations required under the IME3 as they apply to licence exempt distributors and suppliers.
- 2.7 Under Schedule 4 Paragraph 11 of the CEO a closed distribution systems (CDS)<sup>5</sup> may be exempt from the requirement to have a published methodology approved before it comes into force. Schedule 4 Paragraph 15 of the CEO requires that Exempt distribution network operators (ENO) must keep separate accounts relating to their electricity distribution activities.

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<sup>5</sup> Broadly CDSs are distribution systems that are mainly for distribution of energy to non-domestic customers within a geographically confined area.

2.8 More information on the broader requirements for exempt ENOs resulting from Article 32 and other aspects of the implementation of IME3 can be found in the IME3 Regulations and DETI's guidance<sup>6</sup> on their implementation. In this document we focus on the implications of the implementation of the IME3 Regulations for exempt network use of system charging.

### **Requirements of Legislation**

2.9 In July 2011 DETI published a consultation on the introduction of electricity distribution licensing exemptions and the imposition of obligations on licence exempt distributors and suppliers, which amongst other things, amend the Electricity Order to implement the requirements of IME3. Below we summarise the obligations that are the most relevant to our obligations in relation to use of system charges, settling connections disputes and settling lack of capacity disputes.

#### *Use of system charges*

2.10 The CEO defines a Use of System (UoS) charge as being a charge for 'use of the exempt distribution system'. Where the ENO intends to impose a separate charge for UoS it must, within 20 working days, following receipt of an expression of interest:

- a) prepare a record of the assets and liabilities associated with its distribution activities at the time of the receipt of the expression of interest;
- b) prepare a statement (a 'charging statement') containing details of the proposed methodology for calculating the use of system charge;
- c) provide the Utility Regulator with;
  - a. the charging statement,
  - b. any evidence that the distribution exemption holder may wish to provide in support of the methodology proposed for calculating the use of system charge,
  - c. a copy of the expression of interest, and
  - d. such other information or documents as the Utility Regulator may request;
- b) provide the relevant third party with a copy of the charging statement<sup>7</sup>.

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<sup>6</sup> Guidance on the imposition of obligations on licence exempt distributors and suppliers 2013

<sup>7</sup> Schedule 4 Paragraph 5(2)(d) of the CEO

- 2.11 The CEO provides that all UoS methodologies must be approved by us before they come into force. We are required to approve methodologies as soon as is reasonably practicable. If the ENO wishes to change its charging methodology it must also seek our approval. The legislation makes clear that not having had a charging methodology approved is not grounds for refusing to grant TPA. Where a methodology has not been approved ENOs can recover back-dated approved charges subsequent to approval.
- 2.12 We approve the statement containing the methodology and not the charges themselves. This means that new statements do not have to be submitted every time charges change because, for example, of changes in the costs of the distribution activity. It is the responsibility of the ENOs to calculate charges in accordance with their methodology. The CEO provides that a use of system charge must not be imposed by an ENO unless the Utility Regulator has approved the methodology for calculating that charge<sup>8</sup>.

#### *Accounts*

- 2.13 Where it is providing TPA and so long as it imposes a separate UoS charge the ENO must keep separate annual accounts relating to its energy distribution activities<sup>9</sup>. These accounts must:
- a) be sufficient to show and explain the transactions of the distribution business, separate from any other transactions of the distribution exemption holder's business;
  - b) be sufficient to disclose with reasonable accuracy, at any time, the financial position of the distribution business at that time;
  - c) contain entries from day to day of all sums of money received and expended in the course of the distribution business and the matters in respect of which the receipt and expenditure takes place; and
  - d) contain a record of the assets and liabilities attributable to the distribution business.

#### *Connections*

- 2.14 Where providing TPA requires a new connection to be made between the exempt network and a customers' premises or another network, the legislation

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<sup>8</sup> Schedule 4 Paragraph 5(1) of the CEO

<sup>9</sup> Schedule 4 Paragraph 6 of the CEO

allows that the exempt operator may recover 'any expenses reasonably incurred in making the connection'<sup>10</sup>.

2.15 The requirement for the ENO to make a connection is limited to the extent that:

- a) the ENO is prevented from doing so by circumstances outside its control;
- b) circumstances exist by reason of which the connection would or might involve danger to the public, and the ENO has taken all reasonable steps to prevent the circumstances from occurring and to prevent them from having that effect; or
- c) it is not reasonable in all the circumstances for the ENO to be required to do so.

2.16 Other points relating to network connection from the legislation that other parties might like to note are:

- the duty to offer a connection includes a duty to maintain that connection<sup>11</sup>,
- the duty to offer a connection is limited to the duty to connect a third party supply to an existing customer on the network, and
- ENOs are able to request terms from parties wanting connection that might be reasonable in the circumstances<sup>12</sup>.

#### *Closed distribution systems*

2.17 The legislation allows the Utility Regulator to classify certain electricity distribution systems as closed distribution systems ('CDSs')<sup>13</sup>. ENOs who wish to be classified as a CDS must apply to us to be classified as such. Being classified as a CDS means the ENO does not need to have their methodology for charging for use of system approved by us unless the customer or third party supplier requests this<sup>14</sup>.

#### *Third party access – lack of capacity provisions*

2.18 The legislation permits the ENO to refuse the third party supplier access to its distribution system on the grounds of lack of capacity if:

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<sup>10</sup> Schedule 4 Paragraph 8 of the CEO

<sup>11</sup> Schedule 4 Paragraph 7(5) of the CEO

<sup>12</sup> Schedule 4 Paragraph 9(3) of the CEO

<sup>13</sup> Schedule 4 Paragraph 11 of the CEO

<sup>14</sup> Schedule 4 Paragraph 14 of the CEO



- it is not technically feasible to provide the increase in capacity in question, or
- providing that increase in capacity would have a significant and adverse economic impact on the distribution exemption holder or any other person<sup>15</sup>.

2.19 If the third party supplier has a contract with the customer to supply electricity the third party supplier can apply to the Utility Regulator to determine whether the distribution exemption holder is entitled to refuse access on the grounds of lack of capacity<sup>16</sup>. We can, at the request of the third party supplier, ask the distribution exemption holder to provide information regarding what would be required to reinforce the system to provide the necessary capacity and the exemption holder can recover the costs from the supplier of providing this information. In determining whether the distribution exemption holder is entitled to refuse access, the Utility Regulator must decide whether:

- the distribution exemption holder would need to increase the capacity of its distribution system in order to give the third party supplier access to it, and
- it is not technically feasible to provide the increase in capacity, or the benefits of the increase in capacity would be outweighed by the economic impact that the provision of the increase in capacity would have on the distribution exemption holder or any other person.

#### *Dispute resolution*

2.20 The Regulations also require the Utility Regulator to resolve access disputes arising out of complaints made against a distribution exemption holder<sup>17</sup>. This is discussed further in Section 5.2 of this paper

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<sup>15</sup> Schedule 4 Paragraph 1(5)(b) of the CEO

<sup>16</sup> Schedule 4 Paragraph 3 of the CEO

<sup>17</sup> The Electricity (Dispute Resolution) Regulations (Northern Ireland) 2013 amending Article 31A of the Electricity (Northern Ireland) Order 1992

### **3 USE OF SYSTEM CHARGING METHODOLOGIES**

- 3.1 In this section we set out the principles that we will use to assess charging methodologies submitted to us. We also provide guidance on submitting charging methodology statements
- 3.2 We intend to take a proportionate approach to approving the methodologies. For larger ENOs, depending on their circumstances, we would need a greater level of detail in their submission than is given in the in pro forma example where they are able to provide the information and this chapter sets out what this information might include. For very small ENOs with one or two small customers we would not necessarily expect them to provide the level of detail contained in our pro forma.
- 3.3 We may review this guidance document after an appropriate time, once we have experience of approving charging methodology statements with a view to providing clarity on what a large ENO is and updating the information we would expect them to include in the charging methodology statement. In the meantime we may seek further detailed information, if it has not already been provided, from certain ENOs before we approve their charging methodology.

#### **Charging principles**

- 3.4 In approving charging methodology statements we will consider two charging principles:
- the resulting tariffs must be justified by reference to the costs of the distribution network, and
  - costs must be allocated to individual network users on an objective, justifiable and non-discriminatory basis.
- 3.5 The main purpose of network charges is to recover the costs of maintaining and operating the distribution network. Therefore the key principle underpinning any charges should be that they reflect these costs.
- 3.6 Typically a network will have more than one customer and therefore the network costs will need to be shared between all customers. The principles require that network costs are allocated fairly and objectively in a reasonable manner across all customers. This will include customers who use third party suppliers and other customers, including those using a supplier affiliated with the ENO.

### **Guidance on the completion of the charging methodology statements**

3.7 The aim of our guidance is to assist ENOs in developing charging methodologies in a way that fits the needs of their businesses. We also want to make the process of developing charges to minimise the burden placed on the ENOs, recognising that, for the most part, the distribution of energy would not be the main focus of their businesses.

3.8 To this extent ENOs can use a pro forma of a charging methodology statement setting out annual charges, which the Utility Regulator can approve if all the relevant information has been included.

3.9 The pro forma and guidance in chapter 4 are intended to help ENOs put together their charging methodologies while minimising the burden on them. For the purposes of clarification we are not placing a requirement for ENOs to complete the use of system charging methodology pro forma. For example for a small ENO with one or two small customers we would not necessarily expect them to provide the level of detail contained in our pro forma. A submission is likely to be acceptable if it:

- provides a reasonable and proportionate method of identifying costs,
- complies with the charging principles set out above in paragraph 3.4,
- has been substantiated with supporting data, recognising that there may be issues associated with data availability and there are circumstances where estimates may need to be made
- provides an explanation of how the costs have been allocated between network users, and
- allows parties to understand the basis on which their charges have been calculated.

### **Guidance on use of system charging methodology statements for larger ENOs**

3.10 In addition to the information set out in the pro forma, larger ENOs should also consider providing the following information in the charging methodology statement:

- detailed information to substantiate network costs that will be recovered through use of system charges, particularly where costs have been apportioned,

- whether these costs will be recovered through ongoing or one-off use of system charges,
- an assessment of the types of customers connected to their network and how they are likely to affect the allocation of charges,
- what the charges are for different categories of customers preferably with examples of different customers and how their charges would be calculated,
- a long term assessment of how charges are likely to change and how they will affect different types of customers,
- a justification of why the charges that will result from the application of the methodology will satisfy the charging principles.

### **Further guidance**

3.11 We reiterate that there is no pre-defined single structure for use of system charges. We recognise that a wide variety of circumstances could apply to ENOs. Some larger ENOs may already have a set of charges in place and may wish to use this for their use of system charges.

3.12 Other ENOs may have a very different contractual relationship with parties connected to their networks. One common example is likely to be where the ENO has a long term rental or leasing agreement with the customer. In these circumstances there may, for example, be no separate energy charge with the rental charges being on a pound per square metre basis. Again it may be appropriate for the ENO to use this tariff structure to bill its ongoing use of system charges.

3.13 The key points for ENOs are that the use of system charge is separately identified, that they should take reasonable and proportionate steps to ensure their charges comply with the principles outlined in paragraph 3.4 above and that they should provide substantiating information on the method they have used.

### **Identifying network costs**

3.14 The charging methodologies should only seek to recover costs associated with energy distribution activities. Our powers under the legislation only allow us to approve methodologies for calculating energy distribution charges. Therefore, we will not be able to approve methodologies submitted to us which include costs not related to energy distribution in the calculation of use of system

charges. Below we set out some examples of costs that can and cannot be recovered through an approved use of system charging methodology.

### **Losses on bulk purchase agreements or “take or pay” energy supply contracts**

- 3.15 Where ENOs are also suppliers of energy to customers connected to the network they often purchase the energy in bulk and then sell the energy on to their customers. The bulk purchase contracts typically include a requirement to purchase a minimum amount of energy, and such contracts are also known as take or pay contracts.
- 3.16 Where customers choose to switch suppliers an ENO could face potential losses for example where an ENO is required to purchase a certain amount of energy, but because one or more customers has switched suppliers, the ENO is unable to sell all of this energy to customers connected to its networks.
- 3.17 Our view is that any losses on supply contracts resulting from customers switching cannot legitimately be recovered through approved distribution use of system charges. We take this view because these are related to supply rather than distribution activities and the Directives, and the legislation, make a clear distinction between these.
- 3.18 We note that in their guidance document<sup>18</sup>, DETI provide further guidance on the treatment of bulk purchase agreements.

### **Costs related to distributed generation**

- 3.19 Some ENOs may supply energy to customers connected to their networks through decentralised (distributed) generation assets they also own and operate. By changing suppliers the ENO is no longer able to recover the capital and operating costs of these generation activities from their customers although they invested in these assets on the basis that they would be able to do so.
- 3.20 Our view is that costs associated with power generation cannot legitimately be recovered through approved distribution use of system charges. We take this view because these costs are related to generation/supply activities of rather than the energy distribution.

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<sup>18</sup> Guidance on the imposition of obligations on licence exempt distributors and suppliers Chapter 5

### **CRC Energy Efficiency Scheme costs**

3.21 It is our view that the costs of meeting the requirements of the CRC Energy Efficiency Scheme or emission trading schemes cannot be recovered through use of system charges because they relate to supply rather than distribution activities.

### **Costs of providing TPA**

3.22 We consider that any associated costs of providing TPA such as any costs associated with metering and billing services could be recovered through use of system charges. For example, the costs associated with obtaining metering information from a third party supplier in order to derive supply data from the rest of the ENO's customers could be recovered.

## 4 GUIDANCE ON COMPLETING THE PRO FORMA

### Completing the use of system charging methodology pro forma

- 4.1 We have considered the appropriate level of information that we will need from ENOs in order to approve their charging methodologies. Appendix 1 sets out an example of a pro forma of a use of system charging methodology.
- 4.2 The pro forma provides an illustrative example of how the ENO can submit the information. If there is further information the ENO considers is relevant to its submission then ENOs are welcome to amend the pro forma document. However, it would be helpful for us to understand why the pro forma has been amended.
- 4.3 Wherever possible we would also require information to substantiate the information provided in the pro forma. Failure to provide this information could lead to delays to the approval of the methodology.
- 4.4 The pro forma is designed to help to identify the kind of information we would expect to see when approving a charging methodology. However, other approaches will be acceptable.
- 4.5 We have also published a spreadsheet template that may assist ENOs when completing the proforma. It is set up to allow a 10 year view of the costs and charges
- 4.6 Within the spreadsheet, the yellow cells are input cells. The green cells have automatic calculations in them and the orange cells are for data that is determined externally, ie in this case the inflation forecast value would need to be completed by based on actual forecast data.

### Definition of terms used in the pro forma

- 4.7 The pro forma contains a number of terms which are defined below.
  - **Current value of the network asset** – This is the current book value of the network asset.
  - **Direct operating costs** - Direct costs are the operating costs that can be directly attributed to the distribution network. In our example we include labour costs, materials, network maintenance costs and network repair costs.

- **Indirect operating costs** - Indirect costs are operating costs that cannot be directly attributed to the distribution network specifically. In our example, we include IT and telecoms costs, audit and finance costs and insurance.
- **Total operating costs** – Operating costs are the summation of direct and indirect operating costs.
- **One-off upfront costs** - These are costs which the ENO has incurred in order to facilitate third party supply for its customer. We do not envisage that this will include connection or network upgrade costs as these costs are unlikely to be recovered upfront. In our example we include the costs of agreeing a contract with the third party supplier for enabling access to the network and the cost of connecting the supplier's meter to the distribution network.
- **Opening asset value** - The opening asset value is the book value of the network asset at the start of the year.
- **Closing asset value** – The closing asset value is the opening asset value minus depreciation over the year.
- **Cost of capital** – This is the rate of return the network operator expects to receive from providing the network asset and services.
- **Depreciation** - Depreciation is calculated as the current book value of the asset divided by the number of years that the ENO has decided to depreciate the remaining book value of the asset over.
- **Tax** – Taxation costs to be recovered from network users

### **Sections 1 and 2 of the pro forma**

- 4.8 Section 1 of the pro forma provides us with information to understand the nature of the ENO's business and distribution activities, as well as contact information.
- 4.9 Section 2 of the pro forma enables the ENO to confirm that they have met the requirements of the charging principles when setting out the methodology and provide an explanation of how they have met the principles. For clarification we will make our own assessment of whether the ENOs are meeting the charging principle obligations based on all the information they provide in their submission.



### **Section 3 of the pro forma: Deriving network charges**

4.10 We have calculated total annual costs as annual asset costs plus direct costs plus indirect costs plus taxation costs. In addition, we envisage that ENOs may incur one off upfront costs.

#### *Annual asset costs*

4.11 In the example given we have used a notional cost of capital and asset life to determine the depreciation value. We appreciate that the cost of capital is likely to be different for different ENOs so we would expect this figure to be substantiated with supporting evidence.

4.12 We will also require information to substantiate the ENO's assessment of the current book value of the network asset. We appreciate that in some instances it may not be possible to calculate the total network book value, for example where gas pipes, electric wires and telecom wires were laid together at the same time. If so, then some apportionment of cost would be acceptable as long as it is accompanied by an explanation of how these costs have been apportioned and an assurance that appropriate and proportionate steps have been taken to identify the value of the distribution assets in question.

4.13 Some ENOs may have to estimate the value of their asset, particularly where the assets are very old. In this case it would be acceptable to populate the pro forma with estimated figures as long as the ENO can sufficiently explain, for example in section 6 of the pro forma, why it was not possible to include actual costs.

#### *Direct and indirect costs*

4.14 As with asset costs some apportionment of direct and indirect costs is likely to be necessary therefore as set out in paragraph 4.10 we would need an explanation of how these costs have been apportioned.

4.15 In the pro forma we have assumed that direct and indirect costs will be remunerated through the use of system charge in that year. However, it may be the case these costs have been financed and are payable over a number of years in which case please annotate the pro forma as appropriate.

#### *Taxation*

4.16 ENOs may also want to include taxation costs arising from the operation of the distribution system in the total costs of the network. As with indirect costs

we would need an explanation of how these costs have been apportioned to the distribution business. For simplicity, our example assumes taxation costs are zero.

#### *One-off upfront costs*

- 4.17 It will be for the ENO to determine whether these costs are recovered through the use of system charge, which may lead to much higher charges in the first year or whether to bill these costs separately and also whether they wish to capitalise the costs.
- 4.18 In our example we have assumed that one-off costs will not be recovered through use of system charges. However we consider that they should still be identified in the use of system charging methodology statement and have included it in the pro forma.

#### **Section 4 of the pro forma: Allocation of total annual costs**

- 4.19 This information is key to customers understanding how their costs have been derived. In our example we have taken total annual costs and divided it by the number of customers on the network to calculate the annual charge. Other approaches could allocate costs based on energy consumption, rental space etc.
- 4.20 The ENO will need to consider the different characteristics of their customers and apportion costs accordingly. For example if one customer has very volatile demand that requires network investment to ensure that its peak demand is met they may incur a higher distribution charge than a customer with low and stable demand. Also, if one customer is much larger than another customer and consumes significantly more energy it may not be appropriate for them to face similar charges.
- 4.21 The pro forma should include an explanation of why the method of allocation charges to customers was chosen.

#### **Section 5 of the pro forma: Issues that are likely to affect future charges**

- 4.22 Although the use of system charging methodology does not include charges and the Utility Regulator is not responsible for approving an ENO's charges, we consider that parties should be able to understand the basis on which the charges have been calculated by looking at the methodology. Therefore, if the ENO envisages future investment that is likely to affect charges, we would

expect the ENO to set out the details of the investment and how it is likely to affect charges.

- 4.23 In the example shown in the excel spreadsheet and pro forma we illustrate how capital expenditure of £5m impacts on annual asset costs and consequently network charge.
- 4.24 For clarification we do not expect ENOs to re-submit their use of system charging methodology statements to us if they undertake investment in the future which changes their charges, unless it results in a change to the methodology for calculating and/or allocating the charges.
- 4.25 In the use of system charging methodology statement we expect ENOs to provide information on how often they envisage their charges to change, how they intend to notify their customers of a change to charges and how much notice they will give their customers before the change to charges takes effect.

**Section 6 of the pro forma: Any other relevant information**

- 4.26 This section provides ENOs with the opportunity to include any other information that might be relevant to their submission. If ENOs have provided estimated asset costs they can use this section to explain why they were unable to use actual costs.

## 5 CONNECTION TO LICENCE EXEMPT DISTRIBUTION NETWORKS

- 5.1 This chapter is intended to provide ENOs and other parties with the factors we would consider if we are asked to determine on a connection charge. This section includes a summary of the legislative requirements and the types of connection costs that could be incurred when making a connection to the network. As connections tend to be bespoke we have not commented on what constitutes reasonable costs but will review the costs on a case by case basis.
- 5.2 It is intended that we will follow the procedures set out in our published document 'Policy on the Resolution of Complaints, Disputes and Appeals and Guide for Applicants'<sup>19</sup>.

### Legislative requirements

- 5.3 The duty to connect a third party only applies where:
- the party wanting to connect can provide evidence that at least one third party supplier is willing to supply them with energy, and
  - the ENO has not demonstrated that it is entitled to refuse access on the basis of lack of capacity as provided for in the legislation<sup>2021</sup>.
- 5.4 However, the ENO will not be required to make a connection if:
- a) the ENO is prevented from providing a connection by circumstances outside its control;
  - b) the connection would or might involve danger to the public and the ENO has taken all reasonable steps to prevent such risk of danger; or
  - c) it is not reasonable in all circumstances for a connection to be provided<sup>22</sup>.
- 5.5 In the event that an ENO demonstrates that it is entitled to refuse access on the ground of lack of capacity or that it meets the circumstances that prevent it from providing a connection, the third party supplier can request that the Utility Regulator makes a determination on the dispute under the Electricity Order<sup>23</sup>.

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<sup>19</sup>[http://www.uregni.gov.uk/uploads/publications/Utility\\_Regulator\\_Appeals\\_Complaints\\_and\\_Disputes\\_Policy\\_June\\_11.pdf](http://www.uregni.gov.uk/uploads/publications/Utility_Regulator_Appeals_Complaints_and_Disputes_Policy_June_11.pdf)

<sup>20</sup> Schedule 4 Paragraph 1(5) of the CEO

<sup>21</sup> The lack of capacity provisions only apply where the exempt network operators need to increase the capacity of their network to provide third party access and they can justify not providing additional capacity against the criteria outlined in paragraph 1(5) of the CEO.

<sup>22</sup> Schedule 4 Paragraph 8(5)(c) of the CEO

<sup>23</sup> Article 31A of the Electricity Order

## **Connection charges**

5.6 The CEO allows licence exempt network operators to recover any expenses reasonably incurred in making a connection to its network. Connection costs are usually considered to be the incremental cost of connecting a customer or supplier to a network. Connection to the network tends to be bespoke and therefore we are not able to provide guidance on what constitutes a reasonable charge for connection in this guidance document. Reasonable expenses can only be judged on the circumstances of each case and the complexity of the connection required. However, below we set out the types of costs that are likely to be associated with a connection. This is not intended to be an exhaustive list but illustrative of connection costs that a licence exempt network may face. These costs can include:

- budget estimates
- procurement costs
- assessment and design costs
- material costs
- land rights negotiations
- excavation costs
- cabling/pipeline costs
- jointing to the network
- inspection and testing.

### **Budget estimate**

5.7 This could be a high level initial assessment of the costs of a connection without the detail of an assessment and design to give the third party supplier/customer an initial idea of costs before a decision is made to go ahead with the connection.

### **Procurement costs**

5.8 In the event that an ENO procures the services of a third party to undertake the connection work on its behalf it can recover the costs from the third party supplier.

### **Assessment and design costs**

5.9 This is likely to be a detailed assessment of the appropriate location of connection, setting out the design of the connection and costing of assets

required for the connection. We would envisage that the assessment and design will determine the full cost of the connection and would form part of the connection contract. The assessment and design costs are likely to identify and quantify some of the costs below.

### **Material costs**

5.10 These are the costs of all the materials involved in making the connection, other than cabling costs.

### **Land rights negotiations**

5.11 If the connection runs through land owned by a third party there are likely to be costs associated with negotiating the rights to access the land either for excavating the land to install pipelines, cabling or overhead lines.

### **Excavation/Construction costs**

5.12 Costs of excavating to lay down pipelines or construction for the cables for the connection.

### **Cabling costs**

5.13 The costs of procuring cabling for the connection. This cost could be included in material costs.

### **Jointing to the network**

5.14 Once the connection work is complete this involves the costs of physically connecting the connection to the existing network.

### **Inspection and testing**

5.15 Ensuring that energy is flowing safely prior to finally commissioning the connection.

## **6 PROCESS FOR APPROVAL OF METHODOLOGIES**

- 6.1 ENOs are only required to bring forward a methodology for approval where they have received an expression of interest from those connected to or seeking a connection to their network, and where they intend to make a separate use of system charge for it.
- 6.2 Under the CEO, the Utility Regulator should make a decision on approval of charging methodologies as soon as is reasonably practicable. It is difficult to commit to a generic timeframe for approving methodologies since the level of work will depend on the quality of the submissions and the time it takes to get any additional information from the ENO that we need to make a determination.
- 6.3 Once we have approved or decided not to approve the charging methodology statement we will publish our decision letter on the Utility Regulator website as well as providing copies to the parties concerned. We do not intend to publish the ENO's charging methodology statement.

## **APPENDIX 1 – USE OF SYSTEM CHARGING METHODOLOGY STATEMENT PRO FORMA**

Set out below is the pro forma for approving charging methodologies for third party access to licence exempt Distribution Networks (ENOs).

The pro forma has been completed to give an indication of the information we would be expecting to see from ENOs. The example charging methodology is intended to help a customer of the network understand how their use of system charge has been derived.

A blank pro forma is provided as an attachment to this document.



## **Methodology for use of system**

### Section 1: Information about the ENO

Name of business:

Address of business:

Contact name:

Email address and phone number:

Description of the main activity of the business:

Number of customers connected to the network:

Total annual energy consumption of all customers connected to the network for the last full calendar year:

Geographic size of network:

Brief description of the main activity of the customers connected to the network:

## Section 2: Confirmation that you have conformed to the two charging principles

Please confirm that your charges:		Tick box
Are justified by reference to the costs of your distribution network		✓
Have been allocated to individual network users on an objective, justifiable and non-discriminatory basis		✓
<b>Please explain how you have conformed to the two charging principles (referring to subsequent sections of this methodology if required):</b>		
<p>Use of system charges are calculated as operating costs plus depreciation plus a return on the average asset base in any year.</p> <p>Use of system charges relate only to the cost of our distribution network. Each customer takes an equal share of the charge. This is appropriate because each customer makes use of the distribution network in any year and customers have similar energy consumption, capacity requirements and profile of demand usage on the network.</p>		

**Section 3: Explanation of how you have derived your costs (Illustrative, for guidance only)**

Type of cost	Cost (£)
<b>Distribution Network Cost (explain how the cost was derived)</b>	
Total value of network asset	£10m
Cost of capital	8.5%
Asset life (remaining years the asset will be depreciated over)	25
<i>Annual Capital Cost (approximately)</i>	<i>£1.2m</i>
<b>Annual Direct Costs</b>	
Labour costs	£0.25m
Materials	£0.25m
Network maintenance	£0.25m
Network Repair	£0.25m
<i>Total Annual Direct Costs</i>	<i>£1m</i>
<b>Annual Indirect Costs</b>	
IT and telecoms	£0.2m
Finance and Audit	£0.5m
Insurance	£0.3m
<i>Total Annual Indirect Costs</i>	<i>£1m</i>
<b>Tax</b>	<b>[£0m]</b>
<b>One off upfront costs</b>	
Contract costs	£0.01m
Connecting supplier's meter to distribution network	£0.02m
<b>Total Annual costs = Annual asset costs + direct costs + indirect costs + taxation costs</b>	<b>£3.2m</b>
Please confirm that these costs only include network costs	✓

#### **Section 4: Explanation of how you have allocated your total annual charges**

**Detail how you intend to allocate the total distribution costs to your customers (e.g. divide the costs by number of customers, square metre of rental space, annual consumption of energy)**

There are 200 customers connected to the distribution network who have similar energy consumption so we would calculate the charge for each customer as  $3.2/200$  of the total annual distribution cost i.e. approximately £16,165 per annum. (Numbers are illustrative)

#### **Section 5: Issues that are likely to affect future charges**

**Details of any future investment that is likely to affect your charges**

In 2013/14 we intend to reinforce the network. The estimated cost of this investment is £5m. This will increase our annual distribution costs and will result in an increased annual distribution charge to individual customers.

**How often do you envisage distribution network charges will change?**

We intend to review our charges every year to ensure that costs recovered from customers are broadly in line with our distribution network costs taking into account inflation, the depreciating value of the network asset and the cost of our annual direct and indirect costs.

**How do you intend to notify customers of a change to charges and how much notice of a change to charges will you provide?**

We intend to provide our customers with 3 months' notice of a change to charges and will notify them in writing. They will also be able to find the charging methodology statement on our website.

**Section 6: Any other relevant information**

n/a

Signed by -----

On behalf of (company name) -----

Date -----

## **APPENDIX 2 – GLOSSARY OF TERMS**

### **A**

#### *Asset life*

The life of distribution assets can be defined with regard to the technical life of the asset or the economic life ("usefulness") of the asset.

### **C**

#### *Capital expenditure (capex)*

Expenditure on investment in long-lived distribution assets, such as underground cables and pipes.

#### *CDS*

Closed distribution system

#### *CEO*

Electricity (Class Exemptions from the Requirement for a Licence) Order (Northern Ireland) 2013

#### *Connection charges*

Charges paid by generators and demand customers for connection to the distribution network.

#### *CRC*

Carbon Reduction Commitment

### **D**

#### *Department of Enterprise Trade and Investment (DETI)*

DETI is the Government department responsible for energy policy and climate change policy in Northern Ireland.

#### *Depreciation*

Expense associated with spreading (allocating) the cost of an asset over its useful life.

### **E**

#### *ENOs*

Exempt distribution network operators.

*Expense*

Cost from operations. The opposite of revenues.

**F**

*Former CEO*

Electricity (Class Exemptions from the Requirement for a Licence) Order (Northern Ireland) 1999

**I**

*IME3*

Directive 2009/72/EC of the European Parliament and of the Council of 13 July 2009 concerning common rules for the internal market in electricity and repealing Directive 2003/54/EC.

*IME3 Regulations*

The Gas and Electricity (Internal Markets) Regulations (Northern Ireland) 2011

**N**

*Net Book Value*

The asset's cost minus accumulated depreciation.

**O**

*Ofgem*

National Regulatory Authority for Great Britain

*Operating expenditure (opex)*

Fixed and variable costs associated with the provision of the service (such as access to the distribution network).

**R**

*Retail Prices Index (RPI)*

The Retail Prices Index (RPI) is the most familiar general purpose domestic measure of inflation in the United Kingdom. It is available continuously from June 1947.

**T**

*Third party access (TPA)*

Third party access policies require owners of infrastructure facilities to grant access to those facilities to parties other than their own customers, including other suppliers.

## **U**

### *Use of System Charges (UoS)*

Charges paid by generators and demand customers, usually via suppliers, for the use of the distribution network.

### *Utility Regulator*

National Regulatory Authority for Northern Ireland

## **W**

### *Weighted Average Cost of Capital (WACC)*

This is the weighted average of the expected cost of equity and the expected cost of debt.



### **APPENDIX 3 - CONTACT DETAILS**

Any questions or comments on this document should be directed to:

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The Utility Regulator

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Belfast BT1 6ED

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E: [info@uregni.gov.uk](mailto:info@uregni.gov.uk)

This paper is available in alternative formats such as audio, Braille etc. If an alternative format is required, please contact the office and we will be happy to assist.

## **APPENDIX 4 - ASSOCIATED DOCUMENTS**

[The Gas and Electricity \(Internal Markets\) Regulations \(Northern Ireland\) 2011](#)

[The Electricity \(Northern Ireland\) Order 1992](#)

[Consultation on the Implementation of the EU Third Internal Energy Package](#)

[The Electricity \(Class Exemptions from the Requirement for a Licence\) Order \(Northern Ireland\) 2013](#)

[The Electricity \(Dispute Resolution\) Regulations \(Northern Ireland\) 2013](#)