

Lee Wells  
Northern Powergrid plc  
Manor House  
Station Road  
Penshaw  
County Durham  
DH4 7LA

Direct Dial: 020 7901 7159  
Email: [andrew.self@ofgem.gov.uk](mailto:andrew.self@ofgem.gov.uk)

Date: 6 February 2019

Dear Lee,

**Supplier of last resort arrangements - Request for derogations on recovery of costs in respect of Octopus Energy Limited's Last Resort Supply Payment claim**

This letter covers a direction on all electricity Distribution Network Operators (DNOs) to provide derogations from the Common Distribution Charging Methodology and a requirement to provide 15 months' notice of changes to distribution network charges.

**Background and summary**

*Supplier of Last Resort and Last Resort Supply Payment processes*

We appointed Octopus Energy Ltd (Octopus) as the Supplier of Last Resort (SoLR) to the gas and electricity customers of Iresa Limited with effect from 1 August 2018, after the latter ceased trading.<sup>1</sup> Once appointed, a SoLR may make a claim for a Last Resort Supply Payment (LRSP) from relevant gas and electricity distributors where we have given our consent to the amount claimed.<sup>2</sup>

On 14 December 2018, Octopus submitted notice to us of its intention to claim for an LRSP.<sup>3</sup> We consulted on this and published our decision to consent to Octopus claiming an LRSP of up to £13.20m<sup>4</sup> on 24 January 2019. Our decision set out that £7.24m<sup>5</sup> of this would be recovered from relevant electricity distribution licensees.<sup>6</sup>

*Impact on electricity distribution use of system charges*

The electricity distribution network in Great Britain consists of 14 distribution service areas (DSAs), each operated by a DNO. Iresa Limited supplied customers in all 14 electricity distribution areas at the time of our last resort supply direction.<sup>7</sup>

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<sup>1</sup> [Direction to appoint Octopus Energy Limited as electricity supplier of last resort](#)

<sup>2</sup> Under Standard Licence Condition 9 of the electricity supply licences, relevant distributors are distributors in whose distribution service areas there were premises supplied under the Last Resort Supply Direction, excluding independent distribution network operators.

<sup>3</sup> [Last Resort Supplier Payment Claim from Octopus Energy](#)

<sup>4</sup> Precisely £13,158,974.

<sup>5</sup> Precisely £7,237,436.

<sup>6</sup> [Last Resort Supplier Payment Claim from Octopus Energy: final decision](#)

<sup>7</sup> This includes customers connected to Independent Distribution Network Operators' (IDNOs') networks.

DNOs recover their allowed revenue from customers through Distribution Use of System (DUoS) charges. Standard Licence Conditions (SLC) 13.1 of the electricity distribution licence states that the licensee must at all times have in force a Use of System charging methodology that has been approved by us. The methodology for calculating these charges for customers connected at low and high voltages is the Common Distribution Charging Methodology (CDCM). The CDCM is set out in the Distribution Connection and Use of System Agreement (DCUSA), which requires DNOs to provide 15 months' notice of any change to their DUoS charges unless we direct that the 15-month period of notice need not apply.<sup>8</sup> Where we make such a direction, the notice period must be 40 days.<sup>9</sup>

In accordance with SLC 38.2 of the electricity distribution licence, a DNO receiving a claim for an LRSP must increase its DUoS charges in the following regulatory year (if the claim is received more than 60 days before the start of the regulatory year), or the year after (if the claim is received less than 60 days before the start of the regulatory year), to recover the amount of the claim.<sup>10</sup> Octopus submitted a claim to DNOs on 30 January 2019 meaning that DNOs must amend the DUoS charges that will be effective from 1 April 2019.

Each DNO must then calculate the revenue it has derived from the increase to its 2019/20 DUoS charges, and determine whether there is a shortfall or excess to the revenue targeted (the Specified Amount as defined in SLC 38 of the electricity distribution licence). Any such shortfall or excess must be corrected by a change to its DUoS charges in the following regulatory year (i.e. 2020/21). SLC 38 provides no means for any outstanding shortfall or excess remaining at the end of the second year to be corrected.

This raises a number of issues when considered against the other requirements of the electricity distribution licence and DCUSA. DNOs have subsequently submitted to us a request that we provide:

- consent under clause 19.1B of the DCUSA that the periods of notice described in clause 19.1A of the DCUSA need not apply; and
- consent for electricity distribution licensees to charge other than in accordance with the charging methodologies approved under SLC 13 of the electricity distribution licence (the CDCM).

### **DNOs' proposed approach**

The DNOs propose a supplementary fixed charge to recover the costs associated with Octopus' LRSP claim to be applied in the Relevant Regulatory Year (2019/20). This is in addition to the fixed charge calculated by the charging methodology approved under SLC 13. If the total amount recovered from the supplemental charge in 2019/20 is more or less than the LRSP claim, the affected DNO(s) propose to address this with a second supplemental fixed charge in the year following the Relevant Regulatory Year (2020/21). There will no further adjustment after the second year.

You have written to us on behalf of all DNOs to request a derogation from SLC 13 of the electricity distribution licence and clause 19.1A of DCUSA to allow this to happen.

The resulting supplementary fixed charge will be added by each DNO to the residential customer tariff of each relevant DNO Meter Point Administration Number (MPAN) belonging to it within its Distribution Service Area.

DNOs have forecast the impact of the proposed change as an increase across all DNOs of 0.08 pence per day or £0.29 per year for each residential customer for 2019/2020.

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<sup>8</sup> Clause 19.1A of DCUSA

<sup>9</sup> Clause 19.1B of DCUSA

<sup>10</sup> SLC 38.12

## **Our decision and next steps**

We have considered the request in accordance with our principal objective and statutory duties and decided to grant the requested derogation.

We agree that, in this case, a derogation from SLC 13 of the electricity distribution licence is necessary to add a supplementary fixed charge to residential charges. A derogation is also required from clause 19.1A of the DCUSA to enable these charges to be effective from 1 April 2019, in accordance with SLC 38 of the electricity distribution licence (with any excess or under recovery being reflected in the charges effective from 1 April 2020).

We note that the approach taken by the DNOs will result in increases for residential customers connected to DNO networks, but not for those customers on Independent DNO (IDNO) networks or for non-residential customers. Our view is that all consumers benefit from the protections provided by the SoLR process and that in principle the cost should be spread across all consumers. However, we acknowledge at this stage the approach proposed is pragmatic, given the circumstances and the timings associated with the Octopus' claim and the current LRSP process. We have worked with DNOs, IDNOs and other interested stakeholders over the last year to review the process for recovering the costs associated with an LRSP claim. We are currently consulting on changes to the electricity distribution licence to facilitate this.<sup>11</sup> We consider that, if implemented, these changes will avoid the need for derogations in the majority of future SoLR events.

For the avoidance of doubt, as in this instance no additional costs are being incurred by IDNOs, we do not expect IDNOs to increase charges to their customers.

## **Direction**

The formal direction to all DNOs is found in an annex to this letter.

Yours sincerely,

**Andrew Self**

**Head of TCR, Energy Systems Transition  
For and on behalf of the Authority**

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<sup>11</sup> [Statutory consultation on modifications to the Electricity Distribution Licence to recover the costs associated with appointing a Supplier of Last Resort](#)

## **Annex**

### **Direction made by the Gas and Electricity Markets Authority**

#### **To:**

1. Electricity North West Limited;
2. Northern Powergrid (Northeast) Limited;
3. Northern Powergrid (Yorkshire) plc;
4. SP Distribution plc;
5. SP Manweb plc;
6. Scottish Hydro Electric Power Distribution plc;
7. Southern Electric Power Distribution plc;
8. Eastern Power Networks plc;
9. London Power Networks plc;
10. South Eastern Power Networks plc;
11. Western Power Distribution (East Midlands) plc;
12. Western Power Distribution (West Midlands) plc;
13. Western Power Distribution (South West) plc; and
14. Western Power Distribution (South Wales) plc.

#### **WHEREAS:**

- A. Each of the companies to whom this Direction is addressed (each a "Licensee") holds a licence granted, or treated as granted, pursuant to section 6(1)(c) of the Electricity Act 1989 (the "Distribution Licence").
- B. Standard Licence Condition ("SLC") 38.2 of the Distribution Licence requires each Licensee to increase its Use of System Charges for the relevant regulatory year in response to a valid claim for a Last Resort Supply Payment. If the claim is submitted at least 60 days before the following regulatory year, each Licensee must increase its Use of System Charges and publish the changes prior to the following regulatory year.
- C. SLC 13.1 of the Distribution Licence requires each Licensee to comply with the Charging Methodology as set out in SLC 13 and as approved by the Gas and Electricity Markets Authority ("the Authority"). SLC 13.1 gives the Authority the power to grant the licensee(s) a derogation from the obligation to comply with the Charging Methodology.
- D. SLC 20.3 of the Distribution Licence requires each Licensee to comply with (among other codes) the Distribution Connection and Use of System Agreement ("DCUSA"). Clause 19.1A of the DCUSA requires each Licensee to provide notice of their charges 15 months in advance of the relevant charging year. Clause 19.1B permits each Licensee to not have to comply with the notice period set out in Clause 19.1A, where the Authority issues a direction to that effect. In such a circumstance, the notice period will automatically be 40 days.
- E. We appointed Octopus Energy Ltd ("Octopus") as a Supplier of Last Resort with effect from 1 August 2018. On 14 December 2018, Octopus submitted its claim for a Last Resort Supply Payment ("Octopus LRSP Claim") which the Authority approved on 24 January 2019. The Octopus LRSP Claim was submitted to each Licensee at least 60 days prior to the start of the relevant regulatory year.
- F. Compliance with SLC 38.2 will mean that each Licensee will be unable to comply with

its obligations under SLC 13.1 to charge in accordance with the charging methodologies approved pursuant to SLC 13. Compliance with SLC 38 will also mean that each Licensee is unable to comply with Clause 19.1A of the DCUSA to give 15 months' notice of its charges ahead of the relevant charging year.

- G. We therefore consider it appropriate to make the Directions set out below, for the reasons set out in the accompanying letter dated 6 February 2019, which constitutes notice of our reasons pursuant to the Electricity Act 1989.

**NOW THEREFORE:**

1. The Authority hereby directs that:
  - A. pursuant to SLC 13.1, each Licensee is not required to comply with its obligation to charge in accordance with the charging methodologies approved pursuant to SLC 13, insofar as this is necessary so that each Licensee can comply with its obligation under SLC 38.2 following the Octopus LRSP Claim;
  - B. pursuant to SLC 20.7, each Licensee is not required to comply with its obligation to provide 15 months' notice of any change to its use of system charges pursuant to clause 19.1A of the DCUSA, insofar as this is necessary so that each Licensee can comply with its obligation under SLC 38.2 following the Octopus LRSP Claim.
  
2. The directions shall have effect from the date stated below.

Dated: 6 February 2019

**Andrew Self**  
**Head of TCR, Energy Systems Transition Signed for and on behalf of the Authority**