



Making a positive difference
for energy consumers

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

Direct Dial: 020 7901 7159
Email: andrew.burgess@ofgem.gov.uk

Date: 6 February 2018

Dear Lee,

Supplier of last resort arrangements - Request for derogations on recovery of costs in respect of Co-Operative 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 Co-Operative Energy Limited (CEL) as the Supplier of Last Resort (SoLR) to the gas and electricity customers of GB Energy Supply Limited (GBES) with effect from 30 November 2016, after the latter ceased trading.¹ 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.²

On 13 November 2017, CEL submitted notice of its intention to claim for a LRSP. Following consultation, we published our decision to consent to CEL claiming a LRSP of up to £14.04m on 19 January 2018, and claiming £7.72m from relevant electricity distribution licensees.³

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. GBES supplied customers in all 14 electricity distribution areas at the time of our last resort supply direction.⁴

¹ We gave CEL last resort supply directions under their gas and electricity supply licences on 28 November 2016, effective from 30 November 2016 and available here: <https://www.ofgem.gov.uk/publications-and-updates/direction-appoint-cooperative-energy-gas-supplier-last-resort> and <https://www.ofgem.gov.uk/publications-and-updates/direction-appoint-cooperative-energy-electricity-supplier-last-resort>.

² 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.

³ <https://www.ofgem.gov.uk/publications-and-updates/last-resort-supplier-payment-claim-co-operative-energy-final-decision>

⁴ 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. SLC13 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. Where we make such a direction, the notice period must be 40 days.

SLC38 of the electricity distribution licence states that a DNO receiving a claim for a 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. CEL submitted a claim to DNOs on 25 January 2018 meaning that DNOs must amend the DUoS charges that will be effective from 1 April 2018.

Each DNO must then calculate the revenue it has derived from the increase to its 2018/19 DUoS charges, and determine whether there is a shortfall or excess to the revenue targeted (the Specified Amount as defined in SLC38 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. 2019/20). SLC38 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 SLC13 of the electricity distribution licence (the CDCM).

DNOs' proposed approach

DNOs propose to charge other than in accordance with the CDCM as approved under SLC13, to allow the recovery of CEL's LRSP costs, in both the Relevant Regulatory Year (2018/19) and the year following the Relevant Regulatory Year (2019/20), via a supplementary fixed charge. You have written to us on behalf of all DNOs to request a derogation from SLC13 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 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 annum for each residential customer.

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 SLC13 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 2018 in accordance with SLC38 of the electricity distribution licence (with any excess or under recovery being reflected in the charges effective from 1 April 2019).

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 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 CEL's claim and the current LRSP process.

We have assessed this case on its own merits and consider the approach proposed by the DNOs to be a pragmatic and proportionate solution in this case. We will assess any future derogation requests on their merits and this decision does not fetter our discretion when considering any requests in the future.

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. We will however work with the DNOs and IDNOs to review the LRSP arrangements.

Direction

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

Yours sincerely,

A handwritten signature in blue ink that reads "Andy Burgess". The signature is written in a cursive style with a large initial 'A'.

Andy Burgess

**Associate Partner, Energy System Integration
For and on behalf of the Authority**

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 us. SLC 13.1 gives us the power to derogate each Licensee 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 we issue a direction to that effect. In such a circumstance, the notice period will automatically be 40 days.
- E. We appointed Co-Operative Energy Limited ("CEL") as a Supplier of Last Resort with effect from 30 November 2016. On 13 November 2017, CEL submitted its claim for a Last Resort Supply Payment ("CEL LRSP Claim") which GEMA approved on 19 January 2018. The CEL 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 2018, 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 SLC38.2 following the CEL 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 CEL LRSP Claim.

2. The directions shall have effect from the date stated below.

Dated: 6 February 2018



ANDY BURGESS
Associate Partner, Energy System Integration
Signed for and on behalf of the Authority