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for energy consumers

Distribution Network Operators
and other interested parties

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Derogations for all Distribution Network Operators pursuant to Standard Licence Conditions (SLC) 13A Part E, 13B Part E and 14.12 of the Electricity Distribution Licence and Clause 19.1B of the Distribution Connections and Use of Systems Agreement (DCUSA)

Background and summary

Distribution Network Operators (DNOs) recover their allowed revenue from customers through Distribution Use Of System (DUoS) charges. The methodologies for calculating these charges are the Extra High Voltage Distribution Charging Methodology (EDCM) for the large, industrial customers connected at the highest voltages, and the Common Distribution Charging Methodology (CDCM) for the remaining customers. The CDCM and EDCM are detailed in the DCUSA document.

DNOs use the distribution charging methodologies to calculate all-the-way (ATW) tariffs that end users pay towards the cost of the distribution system. DNOs charge Licensed DNOs (LDNOs) LDNO tariffs that contain discount percentages applied to ATW tariffs to reflect the fact that LDNOs are responsible for the proportion of the distribution network that they operate to supply electricity to the end user. The discount factors are calculated in the Price Control Disaggregation Model (PCDM). The ATW and LDNO tariff structures are dependent on the voltage of connection, which can be low voltage (LV), high voltage (HV) or extra-high voltage (EHV) for demand and generation users.

This letter confirms our minded to position to consent to the requested derogation. This means that DNOs may re-publish LDNO HV demand tariffs for 2020/21, but leave unchanged the other tariffs that are incorrect as a result of the errors described below.

Request for derogations

UKPN

On 1 February 2019, UK Power Networks (UKPN) notified us of an error in its PCDM for the published 2020/21 DUoS charges.¹ The error in the PCDM following the replacement of the suite of charging models led UKPN to undertake testing to establish confidence in the new charge setting models. During the testing phase, the changes to the charging models following the implementation of DCP 306 were erroneously omitted.² As a result, the charging models contain incorrect discount factors in the publication of UKPN's 2020/21 DUoS tariffs.

¹ References to the "Authority", "Ofgem", "we", "us" and "our" are used interchangeably in this document. The Authority refers to GEMA, the Gas and Electricity Markets Authority. The Office of Gas and Electricity Markets (Ofgem) supports GEMA in its day to day work. This decision is made by or on behalf of GEMA.

² <https://www.ofgem.gov.uk/publications-and-updates/dcp306-treatment-ofgem-licence-fees-within-price-control-disaggregation-model>

In its initial derogation request letter, UKPN stated that the impact of correcting the error on individual ATW tariff rates for end users is *de minimis*, whereas the correct application of the discount factors on LDNO tariffs is more material. UKPN's proposed solution was to correct LDNO tariffs to avoid LDNOs being over-charged and retain the existing ATW tariffs published in December 2018 as they foresaw no discernible consumer detriment. The average combined impact of the error was 0.0016% on CDCM ATW tariffs, and 0.38% on LDNO tariffs.

Following discussion with LDNOs in UKPN's distribution services area, UKPN opted to seek a derogation from the Authority to allow it to publish charging statements, specifically Annexes 1 and 2, that have not been fully prepared in accordance with charging methodologies for 2020/21 charging year. This derogation would allow it to maintain the incorrect ATW tariffs while correcting and re-publishing the LDNO tariffs.

ENWL

On 5 February 2019, we received a derogation request from Electricity North West Limited (ENWL) to amend LDNO tariffs in its distribution services area and to retain published ATW tariffs. This was again owing to an error in its PCDM input tables that were set to include changes to the charging models for DCP 306. ENWL's derogation request sought to amend LDNO tariffs as the uncorrected tariffs would result in overcharging LDNOs. The average impact of the error was 0.0007% on ATW tariffs and 0.45% on LDNO tariffs.

ENWL's rationale for retaining ATW tariffs was that the DUoS tariff notice provisions as set out in DCUSA exist to allow suppliers to set retail tariffs a year in advance, and changes to the ATW tariffs would undermine industry practices. ENWL's derogation request proposed that the notice period for certain DUoS tariffs would not apply to allow it to republish LDNO tariffs and for the published ATW tariffs to be maintained.

SSEN

In a letter dated 18 April 2019, Scottish and Southern Electricity Networks (SSEN) requested an aggregated derogation from the Authority for all DNOs. SSEN submitted the request for a derogation due to an error that formed in an ancillary database that contained inputs for the CDCM. DNO Parties procure a Nominated Calculation Agent (NCA) to estimate the typical proportion of the different voltage levels when calculating DUoS tariffs. In the database submitted to the NCA, SSEN's LDNO EHV-connected network was submitted as HV connected when calculating the 'HV split' percentage.³

HV split percentage is an average across DNOs and is used as an input by all DNO parties in their charging models. It enables calculation of DUoS tariffs and allows DNOs to their allowed revenue after accounting for the LDNO discount. Following the recalculation of the HV split percentage, the proportion increased by 8.8 percentage points to 79.5%, affecting all published 2020/21 DUoS tariffs.

As a result of this error, DNOs cumulatively may potentially over-charge £1.15 million from LV demand customers and £0.33m from HV demand customers based on projected demand for the 2020/21 charging year. This equates to 4p/customer/year on average for LV demand customers and £13/customer/year for the 24,000 HV demand customers in 2020/21 (based on assumed consumption). Conversely, there would be an estimated under-charge from the published LDNO tariffs of £1.6m for HV demand customers equating to reduction of 3.46%, with minimal impact on LDNO LV demand and generation tariffs.

To minimise disruption to consumers, SSEN proposed to retain the existing published DUoS ATW demand and generation tariffs, and the LDNO LV demand and LDNO generation tariffs for 2020/21. These tariffs would remain in place based on the uncorrected HV split percentage as the error had a minimal impact on these tariffs. This means that all tariffs for

³ A typical proportion of the HV network which is provided by a DNO in the case of HV loads supplied through an HV-connected embedded network.

end consumers and some LDNO tariffs are unaffected by the identification of the error and our decision. In its impact assessment, which accompanied the derogation request, SSEN considered the impact on end consumers and the broader industry disruption of republishing all DUoS tariffs.

SSEN has stated in its derogation request letter that it intends to re-publish LDNO HV demand tariffs based on the corrected HV split percentage. This is because the input error in the charging models had the greatest impact on LDNO HV demand tariffs and the DUoS revenue recovered from LDNOs, reduce the likelihood of potential gains to LDNOs of circa £1.6m at the expense of end users. In the consolidated derogation request letter, SSEN proposed to address the imbalance in the recovery of the allowed revenue from LDNOs via the LDNO HV demand tariffs, and to seek a derogation from at all times implementing and complying with the charging methodologies for the remaining tariffs.

Our Minded to Approach

On 30 August 2019 in a letter we indicated that we were minded to approve SSEN's derogation request.⁴ We acknowledged that SSEN had informed us of the error in the HV split percentage affecting all DNOs and taken steps to communicate and assess the impact on stakeholders.

In parallel, we recognised that, as a result of the HV split percentage error, each licensee is unable to at all times implement and comply with the charging methodologies as set out in Standard Licence Conditions (SLC) 13A and 13B Part E, specifically conditions 13A.4 and 13B.4. They are therefore not able to comply with the requirements of SLC 13A.4 and 13B.4 of their distribution licence conditions and will consequently require a derogation under SLCs 13A and 13B Part E.

In our minded to position letter, we requested acknowledgement and confirmation from each licensee that they are seeking a derogation from the requirement to at all times implement and comply with elements of the charging methodologies. Specifically, ATW tariffs and some LDNO tariffs will remain in place based on the uncorrected HV split percentage as per SSEN's consolidated derogation request.

Our Assessment and stakeholder feedback

HV Split Error

We received eight responses to our August 2019 minded to approve letter. Four of the six DNO companies that responded to our minded to position, consider the impact of the HV split percentage error to be *de minimis* and did not propose to amend their 2020/21 DUoS tariffs. The rationale by some DNOs was that the 2020/21 charges were set in good faith based on the best information that was available when setting the charges.

We recognise that DNOs have used reasonable endeavours when initially setting charges and are mindful of the disruption to end consumers and industry participants of changing charges. We also understand that the ATW tariff charges contain errors that may not in practice be able to be rectified to the degree of accuracy that would be needed to resolve the potential over-charge to end consumers given the calculated average impact was 0.02% for LV demand consumers and 0.03% for HV demand consumers.

UKPN and ENWL

We consider that the impact of the ENWL and UKPN errors are *de minimis* (less than 1 per cent) on ATW and LDNO tariffs. These errors are limited to UKPN and ENWL's respective four distribution services areas. The specific source of the licence fee errors in the charging

⁴ <https://www.ofgem.gov.uk/publications-and-updates/minded-approve-distribution-use-system-duos-charges-derogations-all-dnos>

models differ slightly between the two DNOs, but both errors result in a *de minimis* increase in the LDNO charges.

We are directing all DNOs to correct LDNO HV demand tariffs as a result of SSEN's error; we deem that UKPN and ENWL should take the opportunity to also correct LDNO HV demand tariffs for their own errors. This should have the effect of reducing the change in tariffs as correcting the SSEN error will relatively increase the LDNO tariffs while correcting the ENWL and UKPN errors will relatively decrease LDNO tariffs. As for other DUoS tariffs, UKPN and ENWL should not seek to change their other tariffs as we consider their errors to have a *de minimis* impact.

Impact on LDNOs

In our August 2019 minded to approve letter, we sought views from interested parties that consider they may be materially affected by the issues covered in our letter. We did not receive views from LDNOs on the impact of changes to LDNO HV demand tariffs as a result of our minded to approve position. LDNOs charge their end consumers for using their proportion of the network via a 'Relative Price Control'. The Relative Price Control requires LDNO charges to be capped for all consumers at a level broadly consistent with the DNO equivalent charge ie the ATW tariffs. The operation of the Relative Price Control for LDNOs means that corrected LDNO HV demand tariffs would not be expected to feed through to consumers, as LDNO tariffs mirror the host DNO's ATW tariffs.

Two LDNOs responded to our minded to approve letter and requested derogations from compliance with their charging methodologies in order to continue to mirror the existing published 2020/21 ATW tariffs. We consider it would be disproportionate to require LDNOs to request derogations for this purpose, particularly as this is an issue stemming from a DNO error.

Some LDNOs contain embedded networks, for which they charge LDNO tariffs, which should be published 14 months in advance of the charging year. We expect LDNOs to reflect the corrected LDNO HV demand tariffs in their charging statements for 2020/21. We consider that granting derogations to LDNOs is also unnecessary and disproportionate for the purpose of changing LDNO HV demand tariffs with less than 14 months' notice as they will be simply mirroring the host DNOs' tariffs.

Derogations required

In our minded to approve letter we stated that we expected DNOs to seek derogations from complying with Sections 19.3 and 43.3 in DCUSA. Following responses to the minded to approve letter, we no longer consider that such derogations are required. We agree with respondents that the two paragraphs relate to an adjustment in charges "payable", which refer to invoicing discrepancies, and references to "calculation" refers to the application, and not the calculation, of use of system charges.

One DNO also questioned whether requesting the proposed derogation would leave it in a position of seeking to over-charge allowed revenues; there is a Charge Restriction Condition that sets out a licensee's obligation to use reasonable endeavours to ensure that Regulated Distribution Network Revenue does not exceed its Allowed Distribution Network Revenue.⁵ We consider that DNOs have followed reasonable endeavours in setting charges and will be operating under instructions from the Authority to amend charges according to the Direction in this letter.

Redress payments

Given the impact on end consumers, industry participants and wider disruption to industry resulting from the miscalculation of the HV split percentage, SSEN is making a voluntary payment to the redress fund. SSEN is contributing a redress payment of £200,000 to the

⁵ <https://www.ofgem.gov.uk/ofgem-publications/46671/crcs-master-mergedpdf>

Energy Saving Trust that oversees a redress fund by energy companies to charitable organisations active in the energy sector that assist fuel poor consumers.

We consider that SSEN's contribution to the redress fund is an appropriate response to the general detriment caused by the miscalculation due to the scale of the error, consumer detriment and disruption to industry participants. We acknowledge that UKPN, ENWL and SSEN have informed us of the errors as soon as these were discovered and have sought to correct the errors in a pragmatic way to manage consumer detriment and minimise industry disruption. Nonetheless, the errors would have resulted in a breach of their licence conditions had they not been identified and taken steps to resolve them. All three DNOs have begun to take steps to prevent such an error from occurring in future.

- SSEN has committed to continue to develop and implement better processes to remove the risk of any repeat occurrence of further errors. SSEN has been working to refine its processes for future HV split submissions to include an extra layer of data verification to avoid the risk of this type of situation arising again. This improved process explicitly requires that the database entries for each submission are compared against the equivalent data from the previous year, ensuring that any points of variance are understood and can be explained. The new process was finalised before the its submission in October 2019.
- UKPN has reviewed its internal testing processes and is putting in place additional controls and checks to prevent a reoccurrence of the errors. This includes an annual review of the checking process by an independent party to ensure robustness for each pricing round.
- ENWL has taken internal steps to prevent a reoccurrence of the error and remains committed to working to improve industry processes to minimise the risk of any non-compliance.

We would like other distribution network operators to take note of the seriousness with which we take errors that affect charges for distribution consumers, and the consequential consumer detriment that may result. We would like to reiterate the importance of a robust assurance process when calculating network charges. This is particularly important when there are changes to the underlying codes and equations that form the methodology. Should any such error occur in future, we would expect network companies to fully consider the impact on consumers, including pricing volatility impacts, when proposing any corrections.

Direction

We have considered each derogation request in accordance with our Principal Objective and Statutory Duties.

In reaching our decision, we have considered the impact on end consumers and industry participants that will arise by us granting these derogations. We believe that a change in LDNO HV demand tariffs is reasonable to reduce the likelihood of potential gains for LDNOs at the expense of end users. Whereas, we consider that changes to the remaining LDNO and ATW tariffs would be disproportionate given their *de minimis* level and changing them would have the potential to unnecessarily disrupt industry practices to a significant scale.

Direction

The formal direction to all DNOs is found in an annex to this letter. If you have any questions concerning this letter, please contact my colleague Ankita Mehra (Ankita.Mehra@ofgem.gov.uk / 0203 263 9906).

This letter constitutes the reasons for our decision under section 49A of the Electricity Act 1989.

Yours faithfully,

Andrew Self

Deputy Director, Electricity Access and Charging – Energy System Transition

Signed on behalf of the Authority and authorised for that purpose

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. As set out in Standard Licence Condition (SLC) 13A (Part E) and 13B (Part E) the Distribution Licence requires that the Authority may (after consulting the licensee and, where appropriate, any other Authorised Electricity Operator likely to be materially affected) give a direction ('a derogation') to the licensee that relieves it of its obligations under Part A of conditions 13A and 13B in respect of such elements of the CDCM and EDCM, to such extent, for such period of time, and subject to such conditions as may be specified in the direction.
- C. SLCs 13A.4 and SLC 13B.4 of the Distribution Licence require each Licensee to at all times implement and comply with the CDCM and EDCM respectively.
- 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. SLC 14.12 of the Distribution Licence requires that, except where the Authority otherwise directs or consents, each Licensee may only amend its Use of System Charges in respect of any agreement for Use of System if:
 - (a) it has given Notice of the proposed amendment in accordance with paragraph 14.11;
 - (b) the amendment, when made, conforms to the proposals set out in that Notice (except for any necessary revisions resulting from the occurrence of a material change after the Notice has been given, to any of the matters on which the assumptions set out in the statement under paragraph 14.11 were based, and then only to such extent as is necessary to reflect the change in such matters); and
 - (c) the amendment takes effect on 1 April of the relevant Regulatory Year.

F. We therefore consider it appropriate to make the Directions set out below, for the reasons set out in the accompanying letter dated 13 February 2020, which constitutes notice of our reasons pursuant to the Electricity Act 1989.

NOW THEREFORE:

The Authority hereby directs:

Direction under SLC13A Part E

- Pursuant to SLC 13A Part E of the Electricity Distribution Licence, each Licensee is to retain its existing published all-the-way tariffs and the LDNO LV demand and HV/LV generation tariffs for charging year 2020/21, as the licensees are not able to at all times implement and comply with the CDCM as set out in 13A.4 (Part A) specifically originating from the miscalculation of the HV split percentage. For the avoidance of doubt, published CDCM and PDCM models should remain unaltered to maintain consistency with charges that are not amended.
- Pursuant to SLC 14.12 (Part F) in the Electricity Distribution Licence each Licensee may amend prices at less than three months' notice for 2020/21 for LDNO HV demand tariffs.
- Pursuant to Section 2A Clause 19.1B of the DCUSA, that the periods of notice described in Clause 19.1A shall not apply to each Licensee and that the notice period shall instead be 40 days for 2020/21 LDNO HV demand tariffs.

Direction under SLC13B Part E

- Pursuant to SLC 13B Part E of the Electricity Distribution Licence, each Licensee is to retain its existing published all-the-way tariffs and the LDNO LV demand and HV/LV generation tariffs for charging year 2020/21, as the licensees are not able to at all times implement and comply with the EDCM as set out in 13B.4 (Part A) specifically originating from the miscalculation of the HV split percentage. For the avoidance of doubt, published EDCM and PDCM models should remain unaltered to maintain consistency with charges that are not amended.

The directions shall have effect from the date stated below.

Dated 13 February 2020

Andrew Self
Deputy Director, Electricity Access and Charging
Signed for and on behalf of the Authority