

Patrick Cassels
Head of Electricity Network Access
Ofgem
10 South Colonnade
Canary Wharf
LONDON
E14 4PU

By email to: FutureChargingandAccess@ofgem.gov.uk

09 August 2021

Consultation on DNOs' request for directions to disapply the notice periods set out in the electricity distribution licence SLC 14.11 and in clause 19.1A of DCUSA Section 2A in regulatory years 2023/24 and 2024/25

Dear Patrick

Thank you for the opportunity to respond to the above consultation. This response is on behalf of UK Power Networks' three distribution licence holding companies: Eastern Power Networks plc, London Power Networks plc, and South Eastern Power Networks plc.

The RIIO-ED2 price control is likely to see a significant increase in investment in electricity distribution networks with greater use of uncertainty mechanisms to ensure cost allowances better follow the nation's decarbonisation pathway which remains significantly uncertain at this stage. In addition, Ofgem are minded to reform the connection charging and network access arrangements which will lead to an increase in the proportion of costs associated with connections that are funded through DUoS charges.

The Final Determinations, which will include details of the revenue DNOs are allowed to collect from customers through the RIIO-ED2 period do not get published until December 2022, approximately three months before the RIIO-ED2 period starts on 1st April 2023. The current requirement for DNOs to set DUoS charges with a 15 month notice period would mean that no reliable value for allowed revenue in the early years of RIIO-ED2 will be available for charge-setting calculations. This would not only mean that the charges for the early years of RIIO-ED2 may not reflect Ofgem's Final Determinations, the charges for the later years of the price control would have to be adjusted to true-up any differences between Ofgem's decision and charges collected in the early years.

The situation above has the potential to lead to significant volatility in charges for customers. While we understand the benefits of having a longer notice period for charges, we believe that in this transition between price controls, the risk of charge volatility outweighs the benefits. The proposals set out in the letter from the Electricity Networks Association (ENA) on behalf of DNOs dated 5 May 2021, as referenced in your consultation, seek to strike a balance between reasonable notice periods while minimising the volatility customers will see in their DUoS charges.

Our response to the specific consultation questions is included in the appendix to this response and explains our view of what directions would be needed from Ofgem to allow the right balance to be achieved. If you have any questions regarding this response, please contact Ross Thompson in the first instance.

Yours faithfully

A handwritten signature in dark ink, appearing to read 'James Hope', followed by a stylized flourish.

James Hope
Head of Regulation and Regulatory Finance
UK Power Networks

Copy Oliver Day, Income Pricing Manager, UK Power Networks
 Paul Measday, Regulatory Returns & Compliance Manager, UK Power Networks
 Ross Thompson, Regulatory Performance Manager, UK Power Networks

Appendix – Responses to consultation questions

- 1. Do you agree with our initial views on whether to issue directions that the relevant DCUSA and licence conditions do not apply? Please provide evidence to support your views, including on whether any or some directions should be issued and the benefits and risks with each option. If we do issue a direction (or directions):**

i. Should these apply for 2023/24 and 2024/25, or just 2023/24?

We believe a direction is required for setting of 2023/24 charges as Ofgem's draft view of revenue for RIIO-ED2 will not be available until 6 months later through the Draft Determinations and 12 months before the reliable revenue figure is available through Final Determinations in the RIIO-ED2 process. In the absence of Ofgem's Draft and Final Determinations, DNOs would have to base charges on their draft business plans which, historically, have been materially different from Ofgem's view of revenue through Draft and Final Determinations. This could therefore lead to material volatility in charges for consumers.

We also believe a direction for 2024/25 would be beneficial. Without this, DNOs would be expected to set their charges for 2024/25 based upon a revenue value which will only be confirmed through Ofgem's Final Determinations, which is a risk, especially as DNOs would need to have certainty of this by early December 2022 and this would leave no contingency for any delay. A direction to shorten the notice period for 2024/25 would allow these charges to be set based on Final Determinations reducing volatility associated with differences between Draft and Final Determinations.

As a result our view is that directions for both 2023/24 and 2024/25 would best limit charge volatility for consumers, although the notice periods for each charging year might need to be different (see iii below).

ii. Should it be a direction only disapplying DCUSA Section 2A clause 19.1B or also electricity distribution licence SLC 14.11?

We believe directions are required to both DCUSA and the Licence for setting the 2023/24 charges, as both include timelines which would not allow charges to be set taking Final Determinations into account. The obligations of both agreements apply to us, therefore it will be necessary to have the appropriate relief in order to avoid a non-compliance.

A direction would only be required against our obligations under DCUSA for the setting of 2024/25 charges as the proposed timeline would mean charges are still set with at least 3 months' notice meaning no relief from the Licence obligation is required.

iii. If both, what should the notice period be and why?

In line with our comments above, it would be that charges for 2023/24 are set with 40 days' notice which would be approx. mid-February 2023. Charges for 2024/25 (which would usually be published in December 2022), to instead be published afterwards, with 12 months' notice, before the end of March 2023. This would allow both charging years to use the final agreed revenue, ensuring that charges are set to match the allowed revenue.

2. Can you provide any specific evidence about the impact of varying notice periods on contractual arrangements and budgeting?

Currently in order to publish charges with fifteen months' notice we need to forecast the number of customers and units over three winter periods, this is a challenge but we appreciate and understand how having the advance notice of charges provides clarity to some Suppliers. Were the notice periods to reduce this would allow a shorter period to forecast volume of customer and units which reduces the uncertainty in the forecast, ensuring for the charges are as accurate as possible. This is a concern at the current time due to the impact of COVID-19, and the volume of upcoming industry changes, especially in relation to MHHS, which is likely to significantly change the data we will see in future years.

3. Do you agree with our initial views on the potential for a letter of comfort being sufficient to mitigate the main risk for DNOs? If no, please provide evidence of what the remaining risks are with this option?

The approach described using a letter of comfort does not address the underlying issue of charge volatility, it only seeks to address the issue of penalty interest being applied if such volatility materialises. The current conditions already allow discretion in the application of penalties so a letter of comfort is unlikely to have any material impact on arrangements.

Under the proposed approach, we would set charges based upon the forecasts we have included in the business plans which at this point in time have yet to be determined. The final outcome may be different and result in an increase (or decrease) in charges the following year to address any differences. The uncertainty mechanisms might also not be finalised by this November which DNOs will need agreement on to allow this approach to be considered appropriate. This could be avoided if the notice period reduction is followed.

However, if this option were to be taken forward, the precise wording of the letter of comfort is key and a draft of this should be shared with DNOs and stakeholders for comment as early as possible if it is to be used.

4. Do you think the benefit of advanced notice of charges outweighs the risk of significant under/over-recovery over multiple years? Please provide evidence to support your preference.

We recognise that the advance notice of charges provides significant benefit to some Suppliers. We believe that the chance of a significant under / over recovery by some (or all) DNOs alongside the impact this would also have on IDNOs outweighs the benefits as we transition into a new price control. This is in addition to the correction of recovery positions in future years, which will also impact upon the cost reflectivity which Suppliers see in their DUoS charges.

5. Do you agree with our views on the option to use the code modification process to address the timing issues between price controls? If not, can you provide any evidence regarding the benefit of applying a code change?

Yes we agree, the code modification process is too lengthy to start at this time in order to provide all DNOs and Suppliers with sufficient notice of any change. As a DNO we would typically start the charge setting by September each year so notice of any decision would have been required before now for the relevant code modifications to be made.

6. Do you have any further evidence or information that you think is relevant and can help inform our decision?

We are of the view that the only practical solution is to remove the requirement on DNOs to set charges with fifteen months' notice for 2023/24, and instead set them as soon as practical which would be early in 2023 in line with the Licence obligations, alongside appropriate consideration of when is the correct time to set 2024/25 charges.

We also believe that the 15 month notice period should be kept under review as more details become available of the impact of:

- Any reform to DUoS charge arrangements coming from Ofgem's Access SCR or otherwise
- Uncertainty mechanisms set for the RIIO-ED2 period which will dynamically adjust cost allowances and therefore revenue recovery.