National Grid Electricity Distribution and
other interested parties

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Energy Systems, Management and Security
16 January 2024

Derogation to National Grid Electricity Distribution (NGED) pursuant to SLC 13B Part E of the Electricity Distribution Licence

We have granted a derogation to NGED to charge outside of its methodology for extra high voltage (EHV) customers in its East Midlands region for 2025/26. Specifically, it allows NGED to reapportion negative fixed charges for final demand consumers to the capacity charge for the same group of consumers. We consider it is in the interests of its customers overall, and in particular its EHV customers, to mitigate what would otherwise have been an exceptional level of volatility of fixed charges for some EHV customers.

This follows a derogation that we issued to NGED on 28 December 2023 to permit it to publish final charges for its East Midlands customers by 31 January 2024 instead of 31 December 2023.[1] NGED will confirm its draft CDCM tariffs for East Midlands customers as final alongside its publication of final EDCM tariffs for that region.

Background

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 EHV 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 Distribution Connections and Use of Systems Agreement (DCUSA) document.

[1] We have published the 28 December derogation alongside this letter.

NGED's issue and requested derogation

NGED's issue has some similarities to that for which we issued a derogation to Scottish & Southern Electricity Networks (SSEN) Distribution on 1 December 2023.[2] In NGED's case, the issue is driven by a material reduction in allowed revenues between 2024/25 and 2025/26 alongside a small increase in "forward looking" charges. For East Midlands EDCM customers, this would result in some customers receiving a significant credit fixed "residual" charge despite the intention of these charges to recover residual costs from final demand customers. The NGED issue materialised later than the SSEN issue partly due to delays in NGED receiving EDCM input data from a third party.

Unfortunately, we were only made aware of the issue on 21 December 2023, just four working days before the deadline for publishing charges. Owing to the short timescales, NGED initially sought a derogation from the 15-month notice period for publishing final DUoS charges for 2025/26, i.e. 31 December 2023, which we issued on 28 December 2023. NGED published draft CDCM charges by 31 December 2023.

Since then, NGED has investigated an approach to the EDCM methodology for 2025/26 that avoids the perverse outcome of fixed credits for residual network charges. Its proposed solution requires charging outside of its EDCM methodology for 2025/26 for East Midlands, for which it has sought a derogation.[3]

In summary, NGED's proposal seeks to allocate the negative residual charges in a given residual band across all customers in that band. It does this by reducing the capacity charge for each band by the total residual credit for that band divided by the total capacity for that band. In this way all customers in a given band see a uniform capacity charge reduction.

NGED considers this to be a pragmatic solution in the circumstances. It removes the negative fixed charges and reduces capacity charges for all customers in that residual band. It is equivalent to the process that is already applied in the CDCM methodology, where negative residuals are reapportioned across unit rates to CDCM customers. NGED considers that the SSEN approach of carrying over the relevant components of its 2024/25 tariff calculations would be inappropriate. This is because NGED's issue is principally driven by year-on-year changes to allowed revenue rather than the forward-looking component of the charge in the case of SSEN. NGED considers that its proposal can address the issue of

[2] [Derogation to Scottish and Southern Electricity Networks Distribution pursuant to SLC 13B Part E of the Electricity Distribution Licence | Ofgem]
[3] We have published its derogation request alongside this letter.

negative residuals, which are of a lower magnitude than for SSEN, without the need to carry over components of previous year's tariff calculations.

Given the interaction between the EDCM and CDCM, NGED only published draft CDCM charges for East Midlands by 31 December 2023. It wanted to explore the impact on CDCM customers of its proposed solution before finalising CDCM charges. Its proposed solution would result in £2,225 over-recovery from the EDCM. If CDCM charges were to be recalculated in light of this, the biggest impact in absolute terms would be 0.2p/day for a set of customers (equivalent to around 0.005% difference for this tariff component for this group). Given the *de minimis* impact on CDCM customers, NGED will re-publish its draft East Midlands CDCM as final tariffs, unchanged. As a result, its CDCM charges will be consistent with the agreed methodology and will not require a derogation from the CDCM.

Subject to us granting this derogation, NGED plans to publish final CDCM and EDCM charges by 19 January 2024.

Our assessment

We have considered NGED's proposal to reapportion negative EDCM residual charges to capacity charges for its East Midlands licence area against our principal objective and wider statutory duties. We have considered whether alternative solutions, such as carrying over the relevant components of its 2024/25 tariffs calculations would better facilitate the achievement of these objectives and duties.

Competition

NGED informed us that the draft EHV tariffs for East Midlands would result in some EHV users facing negative "residual" charges. We think such a dramatic change in the level of charges is potentially harmful for competition. Negative residuals could lead to distortive incentives for customers to hold or increase agreed capacity where it is not needed, which will not lead to efficient system use and could be harmful for competition if it prevents the efficient allocation of capacity to other users.

We have signalled our intention to look into the presence and impacts of volatility of EHV DUoS charges as part of our DUoS Reform Significant Code Review (SCR) work. We have not formed an opinion on whether broader intervention is needed, but think that a swing from significant positive fixed charges to significant negative fixed charges was unlikely to be predictable to users and so does not aid business planning or investment certainty. NGED's proposal would address these competition concerns in the short term.

Cost reflectivity

Absent this derogation, NGED's EDCM unit and capacity charges would over-recover revenue and then pay fixed credits that do not send a signal for reducing the long run costs of the distribution network. This suggests the over-recovery is inefficient and unnecessary when compared to alternatives such as recovering less from capacity charges in the first place. At a time when both domestic and non-domestic users are facing higher costs of energy, it does not seem reasonable to see consumer money paid out to users in standing charges without clear justification.

We consider it is appropriate for NGED to publish its CDCM charges in line with the agreed CDCM methodology. We consider the EDCM over-recovery from NGED's proposal (c.£2k) is *de minimis* in relation to its East Midlands allowed revenue (c.£600m). Therefore, NGED does not require a derogation from the CDCM.

Process

We recognise that NGED's proposed solution is not the only possible solution, so we have also considered the potential for NGED to carry over the relevant components of its 2024/25 tariffs calculations. While this was appropriate for the SSEN case, we have concluded the NGED proposal is more proportionate in this case as it can address the scale of this issue with minimal changes to the model inputs. It will also ensure that there is minimal delay to the publication of EDCM charges, and that CDCM charges will be unchanged from the drafts of 31 December 2023, providing certainty as soon as practicable.

Under SLC13B.5, licensees must review the EDCM methodology at least once a year and make such modifications to the methodology as are necessary for the purposes of better achieving the Relevant Objectives.[4] Typically, such a modification would be enabled via a proposal to DCUSA to proceed to industry working group development and ultimately for Ofgem decision. In this instance, with the issue only being confirmed close to the date by which charges are due to be published, the usual modification timetable would add significant uncertainty to the tariffs for affected parties. That is, were any such modification ultimately approved, it would significantly reduce the notice period for charges (to a matter of months) and introduce further uncertainty as a result of relatively short-notice changes to published charges.

In addition, we are currently conducting a SCR into DUoS, which limits the ability of DNOs to propose modifications to the charging methodology which overlap with the scope of that SCR. We have recently sought views on our proposal to examine EDCM volatility in the next

[4] The Relevant Objectives are listed in SLC 22A Part B.

phase of that SCR.[5] We will seek to ensure that work considers the causes of the volatility that gave rise to this and SSEN's issue.

We encourage DNOs to examine likely future charges in as far as advance as practicable to ensure any such issues are identified as early as possible.

Impact on licensed distribution network operators (LDNOs) operating in East Midlands

Under the DCUSA, LDNOs[6] are required to provide 14 months' notice of their charges. This is one month after the DNOs publish their own tariffs. For LDNOs operating in the East Midlands, the delay to publication of final NGED charges could affect their ability to meet this timeline.

Given that NGED plans to publish its final East Midlands charges by 19 January 2024, we expect LDNOs should still be able meet the deadline for publishing their own charges by 31 January 2024. However, we think it would be unnecessary and disproportionate for LDNOs to seek a derogation if they are unable to meet that deadline, provided they publish their final charges as soon as practicable after NGED has published its final charges, and in any event no later than one month after NGED has published its final charges.

Decision

We have considered the request in accordance with our principal objective and statutory duties. We have decided to grant the requested derogation in accordance with the Direction below. This letter sets out the reasons for our decision under section 49A of the Electricity Act 1989.

Direction

The Authority hereby directs:

Pursuant to SLC 13B Part E of the Electricity Distribution Licence, NGED (East Midlands) plc may reapportion negative fixed charges for final demand consumers to the capacity charge for the same group of consumers in the EDCM for the 2025/26 charging year. Any new EDCM connections between the publication of charges and the 2025/26 charging year should also have their charges set on an equivalent basis. For the avoidance of doubt, and save as set out in this Direction, in all other respects the charges should be calculated in accordance with the EDCM.

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[5] https://www.chargingfutures.com/media/1602/cff-slide-pack-31-october-2023-final.pdf – see slides 38-41.
[6] An LDNO can be either an independent distribution network operator or a DNO operating outside of its own region.

The direction shall have effect from the date stated below.

Dated 16 January 2024

Yours faithfully,

Andrew Malley
Head of Distribution and Residual Charging

Signed on behalf of the Authority and authorised for that purpose