

Gary Keane  
Distribution Policy Analyst  
Office of Gas & Electricity Markets  
9 Millbank  
London  
SW1P 3GE

Direct Line 01925 237096  
[Mike.boxall@uuplc.co.uk](mailto:Mike.boxall@uuplc.co.uk)

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Dear Gary,

### **Electricity Distribution Rebates to Suppliers**

Thank you for the opportunity to comment on these proposals.

#### **1) DNO Charges**

United Utilities (UU) commercial policy is to set charges to ensure that actual revenues equal the allowed revenue in any year by budgeting every year for a neutral year end position i.e. no over or under-recovery. Where we have over or under-recovered in past years this is primarily due to changes in the economic factors affecting the growth in units and the take up of metering services. There are a number of reasons why forecasting of DUoS revenues is becoming increasingly challenging. These include;

- Growth of customers with own generation
- Growth of embedded networks
- Impact of energy efficiency obligations on suppliers
- Impact of metering competition
- Increased use of incentives mechanisms within the distribution control

It is important therefore that the regulatory framework whilst incentivising the DNO to produce accurate forecasts when price setting, retains flexibility for the DNO to respond to changes as they occur.

To reduce the incentives on DNO's to use rebates as the means of achieving such flexibility Ofgem should consider applying a simple and flexible tariff change mechanism that facilitates tariff changes within the year. The suggestion of a shorter notice period for minor adjustments to charges seems reasonable. This will provide a longer time period for the new charges to run and minimise the price adjustment in percentage terms. Introducing a simple graduated scale matching percentage change to days notice may be an appropriate way forward. This mechanism coupled with removing the punitive interest payable on the over-recovery amounts would considerably reduce any incentive for the DNO to use the rebate mechanism.

Should any DNO be perceived as misusing the rebate mechanism Ofgem holds sufficient powers under the distribution licence to scrutinise the reasons for a rebate and take any action against the DNO involved. As far as we are aware Ofgem has not utilised these powers to investigate any of the rebates given to date.

## 2) Supplier Charges

Whilst we understand the general concerns that have been raised by customer representatives that customer prices have not reflected falls in supplier input prices in recent years there is no evidence to suggest that DNO pricing policies have in any way contributed to this position. As your paper acknowledges it is extremely difficult to measure the impact of changes to DNO charges on the prices charged by suppliers to customers. We are therefore concerned at the implication that a rebate not passed from the suppliers to their customers is in some way the fault of the DNO when there is no evidence to support this statement.

Whilst your paper highlights the absolute amounts given in rebates it does not acknowledge that these equate to a very small percentage of total bills. We do not consider that such amounts have any distorting impact on the competitive supply markets. It is possible they may even provide opportunities for innovative suppliers to use them to enhance their customer loyalty programmes and distinguish themselves from their competitors.

If there is a concern that suppliers don't reduce their charges to their end customers following a rebate from a DNO, there must be concern as to whether suppliers will alter their prices for downward changes in DNO charges part way through the year. We fail to see how this concern will be removed by abolishing rebates. The only way in which to eliminate this problem would be to regulate the way in which suppliers treat changes to DNO charges, which your paper expressly rules out.

Ofgem therefore appear to have ignored the opportunity to seek information from suppliers and gain an insight and clarity on whether suppliers are passing on the rebated sums to the end customer. As this is the primary concern Ofgem should investigate directly with suppliers as without such investigation Ofgem will be unable to demonstrate that customers have seen benefit from the reduced DNO charges whether through rebates or any other mechanism.

## 3) Summary

UU believe that the rebate facility provides a useful mechanism for DNO's to refund suppliers small excess charges collected in a particular year and would not support a licence change to remove this flexibility. Ofgem hold sufficient powers under the licence to investigate the reasons for a rebate and take appropriate action against any DNO for misuse of the rebate mechanism.

Applying a tariff change mechanism that facilitates changes within the year, and removing the punitive interest payable on any over-recovery amounts can improve the process of passing monies back to suppliers.

The only means of ascertaining whether end customers see benefit from reduced distribution charges (whether through rebates or any other means) is to investigate supplier pricing policies directly.

I hope you find these comments helpful and if you wish to discuss any of the issues raised please do not hesitate to give me a ring.

Yours sincerely,

**Mike Boxall**  
**Head of Electricity Regulation**