

Company Secretary
Yorkshire Electricity Distribution plc
Lloyds Court
78 Gray Street
Newcastle upon Tyne
NE1 6AF

*Promoting choice and
value for all customers*

Your Ref: 0007/2007
Our Ref: RBA/DPC/SOC
Direct Dial: 020 7901 7255

cc: Andy Jenkins (by email only)
Harvey Jones (by email only)

15 May 2007

Dear Company Secretary,

Decision in relation to modification proposal 0007/2007 to the use of system charging methodology: revision to reflect the allocation of operating costs to the unmetered supplies customer group

On 27 April 2007, CE Electric UK Funding Company submitted to the Gas and Electricity Markets Authority ("the Authority")¹ a proposal to modify the use of system (UoS) charging methodology for Yorkshire Electricity Distribution plc (YEDL).

The proposal modifies the UoS methodology, formerly calculated by a combination of a fixed charge and a unit charge, by expressing the charges entirely on a units distributed basis within the unmetered supplies (UMS) customer group.

Having carefully considered the issues raised in the proposal, the Authority has decided not to veto the proposed modification.

This letter sets out the background to the modification proposal, explains briefly the proposed changes and sets out the reason for the Authority's decision.

Background

YEDL has licence obligations² to have in place as of 1 April 2005 three charging statements: the statement of UoS charging methodology, the statement of UoS charges and the statement of connection charging methodology. The statement of UoS charging methodology outlines the method by which UoS charges are calculated. YEDL has a requirement to keep the methodology under review and bring forward the proposals to modify the methodology that it considers better achieves the relevant objectives.³

¹ Ofgem is the office of the Authority. The terms 'Ofgem' and the 'Authority' are used interchangeably in this letter.

² Standard licence conditions 4-4B

³ The relevant objectives for the use of system charging methodology, as contained in paragraph 3 of standard licence condition 4 of CE's licence are:

- (a) that compliance with the use of system charging methodology facilitates the discharge by the licensee of the obligations imposed on it under the Electricity Act 1989 and by this licence;
- (b) that compliance with the use of system charging methodology facilitates competition in generation and supply of electricity, and does not restrict, distort or prevent competition in the transmission or distribution of electricity.
- (c) that compliance with the use of system charging methodology results in changes which reflect, as far as is reasonably practicable (taking into account of implementation costs), the costs incurred by the licensee and its distribution business; and

YEDL modification proposal

- YEDL proposes to convert the fixed element of their UMS charge to a p/kWh rate. This would then be added to the existing unit rate. Currently their charges are comprised of a fixed p/MPAN/day charge, and a unit charge on a p/kWh basis.

The April 2007 methodology increased the proportion of revenue recovered through the fixed p/MPAN/day charge. Detailed analysis at an individual customer level has shown that the UMS customer group is particularly diverse, for example city councils that use large amounts of electricity, and parish councils with a very small requirement.⁴ As a result, the size of demand relative to fixed charge at each MPAN can vary significantly. Further details on the impact of the proposal can be found in the **appendix** to this letter.

The Authority's decision

The proposed shift to a unit-only charging structure has a differential impact on customers according to their usage. It attributes a greater proportion of 'fixed' charges (which YEDL bases on annual operating costs) to high usage MPANs than currently, and a much reduced contribution towards 'fixed' costs from low usage MPANs. This redresses the substantial increases to low users in the published April 2007 rates by converting the 'fixed' charge to a unit charge.

YEDL has indicated that usage can be a proxy for maintenance and repair costs captured in the fixed element of the charge in terms of equipment failure rates being broadly related to usage. Equally, YEDL has set out that its inventory management costs rise with the size of inventory.

The Authority has considered the proposal against the relevant objectives and wider statutory duties. We note the difficulty of assigning a common fixed charge due to the highly diverse nature of the UMS customer group. We note that in principle there are likely to be some costs that are fixed in serving customers (e.g. administration), and that a purely unit based charge may not be appropriate in this sense. However, on balance, the change to the UoS charging methodology results in a more cost reflective charge given the impact on low usage customers of a high fixed charge. We would expect YEDL to monitor whether the exclusion of a fixed charge is appropriate going forward.

The Authority has decided not to veto the modification to the use of system methodology statement.

Please contact Colette Schrier on 020 7901 7239 if you have any queries in relation to the issues raised in this letter.

Yours faithfully,



Martin Crouch
Director, Distribution
Signed on behalf of the Authority and authorised for that purpose by the Authority

(d) that, so far as is consistent with sub-paragraphs (a), (b) and (c), the use of system methodology, as far as is practicable, properly takes account of developments in the licensee's distribution business.

⁴ The number of kWh supplied to each MPAN by YEDL varies from less than 10 kWh to over 44,000,000 kWh per annum.

Appendix

From April 2007, income recovery for the UMS customer group increased by 20% from 2006/07 rates due to the approval of a new UoS charging model.

The charges for 2006/7, for the approved methodology from 1 April and the new charges resulting from this modification proposal are set out below:

YEDL	2006/7	Published (April) 2007/8	Proposed new 2007/8
Fixed charge (p/MPAN/day)	19.32	275.235	n/a
Unit charge (p/kWh)	1.02	0.925	1.257

At an end-user (MPAN) level, the approved 2007/8 methodology benefited 3% of MPANs who saw reductions of up to 14%. These were the customers who used the most units. The remaining MPANs saw increases (which were subsequently not implemented by YEDL⁵) of up to around 1300% from 1 April 2007.

4% of MPANs will see their bills rise from the April 2007 figures, up to 27% above 2006/07 rates. 96% of MPANs see their bills fall from April 2007 figures, around a third of which will fall by over 95%.

YEDL has contacted all suppliers about this modification to ask whether they disagree with the proposed changes to their methodology for allocating charges to UMS customers. No suppliers raised concerns with the proposed approach.

⁵ YEDL informed suppliers on 30 March 2007 that it did not intend to implement the published charges in cases where these lead to increases in charges for 2007/8 against the 2006/7 position.