Consumer Focus
Campaigning for a fair deal

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Dear Ynon

DNOs' proposals for a common methodology at lower voltages

Thank you for the opportunity to comment on the DNOs' proposals and Ofgem's "minded to" decisions.

Consumer Focus is the independent champion for consumers across England, Wales, Scotland and (for postal consumers) in Northern Ireland. We operate across the whole of the economy, persuading businesses and public services to put consumers at the heart of what they do.

We generally agree with the minded to positions insofar as they will deliver the CDCM to be implemented by April 2010. However we do have some concerns over the extent of price disturbance in the supply market. This could be compounded by the number of areas where Ofgem expects the industry to undertake further work through the new open governance arrangements, as this introduces the potential for frequent and uncontrolled further change. Further we do not see distributors committing significant effort into communicating these changes and their likely impacts to customers, which is a concern.

Fuller answers to the specific questions raised in the consultation are attached. Below we expand on the issues of price disturbance and the need for orderly change both at 1 April and going forward, and how change is being communicated to customers.

Price disturbance

Ofgem says "the approach being adopted for demand customers is broadly similar to the existing approach for the majority of DNOs at a high level", and it acknowledges that there will be a "consequent tariff migration for some customers" because of the reduction in the number of tariffs. Ofgem go on to say that "common arrangements [entail] some relatively significant impacts on charges for certain customer groups" and that "these changes vary widely across DNOs". The consultation continues "some DNO areas experience steep changes in illustrative charges for some customer categories".

Ofgem cites the following in the consultation document:

- EDF SPN could see the charge for domestic unrestricted customers increase by 24% (corresponding to a 4-5% increase in final bills);
- SSE Hydro could see the charge for domestic two rate customer increase by 46% (9%), and

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- ENW could see its NHH UMS charge increases by 146% (29%).

More generally there is a 24-page set of explanatory schedules from the DNOs on the rationale behind the significant tariff movements.

These large changes could, Ofgem accepts, have large impacts on non-diversified or niche suppliers, but it is clear that customers generally will see significant change from 1 April 2010. However, although Ofgem asks for views in the impact assessment on its proposal that "the charge changes that will result from the implementation of the CDCM on 1 April 2010 should not be phased in", you specifically reject such an approach.

It is very relevant in this context that the numbers presented on CDCM have "bounced around" since indicative numbers have been available since the initial DNO consultation in June/July, which was little more than three months ago. The average tariff change across distributors has moved from around minus 8% (within a range of -22.6 to +10.6%) in the July numbers to around zero (within a range of -17.5 to +20.4%) in the October update, but there have been dramatic changes between companies. This variability is best illustrated by:

- the fact that the ranges cited above at the two different date points have different companies at the two extremes; and
- the fact that one company moves from an average shift in its tariffs of -18.9% to heavily positive at +10% over these two date points.

It is certainly difficult for Consumer Focus—and probably any other stakeholders outside the Big Six energy supply companies to assimilate these proposals given the amount of inherent change within them. We are also unclear on what demand assumptions have been used and whether they reflect recent sustained reductions in consumption, which suggests the average increases could be on the low side.

Ofgem says the latest numbers are illustrative, noting they will anyway change with the final price controls. There is also the probability of further change in the light of methodological change in response to the "minded to " decisions flagged in the consultation (for instance, on the demand-side there seems to be significant scope from revisiting the split of assets across network levels). It is also established practice for distributors to introduce significant changes to their charging arrangements between the publication of indicative tariffs in December and final tariffs in February. In short it is virtually impossible to draw hard and fast conclusions with this level of change in an area that Ofgem indicates could have wide-ranging distributional effects on suppliers (and therefore customers). Ofgem dismisses in the impact assessment competitive side-effects although it is clear some suppliers are less able to manage the risk of change because they do not have the diversity benefit in their customer base.

Put at its simplest most consumers (those on the domestic unrestricted and domestic two rate arrangements) will face average bill impacts of increases of between 1-2% and Ofgem seems to be relying on the fact that the overall increase is relatively small. However these average numbers are twice the level it indicated as arising from its initial DPCR proposals, and there remains significant uncertainty over how the indicative increases will translate into costs on final

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bills. The range around these averages is also wide with some consumers set to see increasing bills of some 5%.

These increases are due to be implemented at a time of other expected increases in the non-energy elements of consumer's bills and will inevitably compound the problems faced by vulnerable customers. As the industry and its regulator has a large degree of control over the nature of these changes and the timing of their implementation, all reasonable steps should be taken to mitigating the effect on consumers' bills.

We are of the view, therefore, that Ofgem should consider a two-year phase-in of the changes. Alternatively as a minimum it should place a specified cap on the maximum change year-on-year, or at the very least a cap on the increase to customer types seeing the greatest increases. With the prospect of further change to come we think the concept of caps (and possibly floors) on actual changes could be retained going forward beyond two years if the scope of further change signalled by Ofgem to LV/HV charging gives rise to further disturbance.

Governance

We are nervous about the emphasis placed in the consultation on the use of industry governance processes before they have been defined. It took DCUSA governance the greater part of a year to get into its stride following designation, and it has not to-date had to deal with any particularly difficult or controversial changes. The extension of its jurisdiction to network charging has yet to be approved. Indeed the comment (p56) that those adversely impact by the changes will have the ability to raise change proposals is questionable at least for a while, as this facility may not be available for some time.

In this context, and presuming current structures are adapted to encompass electricity distribution charging, we are particularly concerned that Ofgem will become detached from the developmental process after making its present decision on CDCM. The only reason the industry has reached the position it has of significant change is because Ofgem have pushed forward the process. We would prefer to see the current process—including the broad definition of change agreed on areas remaining incomplete where a significant methodological issue has been flagged—substantively complete. If this cannot be done before April 2010, this reinforces the need to define clear commitments on the DNOs and a timetable for remaining open areas to be closed out. In this regard Ofgem should urgently reach a view on which of the changes at p38 are "must haves" and which are "nice to have".

Communication

We also have concerns about the efforts being directed by distributors at customer communications strategies given the extent of likely change that customers will see from April 2010. We do not believe that DNOs have done "all they can to keep their customers updated on the impact of their charges," and at Consumer Focus we have not been approached by any of the DNOs on these issues. Ofgem has noted that "not all DNOs have made the same level of commitment regards communicating the impact of the changes", and we believe there is significant further work to be done by the DNOs in this area.

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If you have any questions or would like further information about our response please contact Abigail Hall, Senior Policy Advocate, Regulated Industries Team by telephone on 0207 799 7934 or via email: abigail.hall@consumerfocus.org.uk

Yours sincerely

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CDCM Consultation Questions

Question 1: Do you agree with our minded to positions given the arguments / analysis presented here and in the Impact Assessment in Appendix 3? If not, why not?

We generally agree with the “minded to” positions insofar as they will deliver the CDCM to be implemented by April 2010, but have some concerns especially in areas where Ofgem expects the industry to undertake further work through the new open governance arrangements as this holds out the prospect of frequent and uncontrolled further change. Eleven areas of additional work are listed on p38, and at least three of these could result in further significant change.

As a guiding principle we would wish to see phased further development where this is needed. In instances where there is a recognised, stated defect with an understanding of its materiality and that materiality being modest, the regulator should impose a clear deadline for delivery.

This is particularly the case for the **500MW network model application** of the split of assets across network levels, which is a key driver of customer charges. It is concerning that DNOs may not have implemented the guidance or done so consistently. It does not seem appropriate to impose an open-ended condition on the DNOs to pursue consistency and change in an uncontrolled manner. Rather we would suggest that there should be a firm commitment to review by a defined time-point.

Treatment of replacement costs—we agree these should be excluded.

We agree that the CDCM single input entry for '**other expenditure**' should be broken down to aid transparency. There also seems to be a case for the industry to consider the issue of indirect operating expenditure further.

On **generator charging**, the rationale provided by the distributors for the variation to the October 2008 appears sound. In terms of the minded to position related to the specific issue of connection voltage, clarity should be provided on any difference (or not) between the voltage of connection and the voltage of supply—particularly as the levels of deployment of distributed generation is expected to increase sharply in the near future and this information will be necessary to prospective developers. The suggestion that industry governance should discuss consistency between connection and use of system seems appropriate.

Reactive power charging – the proposed approach appears sensible.

Allocation of costs—we see no reason to disagree with the distributors’ proposal to use “standing charge factors”. If the issue is to be discussed further post-implementation we would like to see a firm commitment date stipulated for conclusion of the review.

For the **revenue matching** application minded to position, the revised approach has been thoroughly justified. We agree DNOs should monitor this issue for developments on their network, particularly the introduction of smart metering and distributed generation. We also question why generators have been excluded, and it is not clear what Ofgem proposes to do about this.

IDNO charging—after the issue of the 500MW network model application this area seems to be the one where significant further work is needed and which could result in the largest changes,

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particularly given Ofgem's stated reservations about technical flaws in the proposed approach. We therefore repeat our concern about the risk of further, open-ended change.

Service models—we agree with the proposed approach subject to demonstration by DNOs that they have applied a common methodology in a consistent manner.

Generator charging in generation dominated areas—with 10GW of DG in the pipeline it is obviously essential that the methodology can be developed to differentiate over-time between demand and generator dominated areas to mitigate the impact on local system reinforcement. If, as Ofgem suspects, some distributors have not reflected this in their charges, this should be corrected. A deadline for review by 1 September 2010 looks reasonable.

Generator charging from 2010—parity between generators is not only fair, but has to be right given the importance Ofgem attaches to cost-reflectivity. It is not clear what the scale of the problem is if distributors cannot levy such charges and how the cross-subsidy will be dealt with.

Network unavailability rebate payments—the rebate scheme is consistent with ensuring proper incentives on distributors to provide continuity of service. We are concerned however that the DNOs failure to incorporate this element of the methodology could once corrected aggravate pressures to rebalance tariffs between now and implementation. That said, it is unclear how material this issue is.

Input data—there remains a considerable amount of further work needed on improving transparency. DNOs should be under an obligation to provide information and timely explanations of changes.

Excess capacity charges—we think a monthly surcharge is proportionate and would in practice be combined with action under the connection agreement. Default charges should be cost-reflective, published and made known to the customer.

Question 2: Do you consider any additional areas should be conditionally approved?

For the reasons set out in the cover letter, we think Ofgem should further reconsider its position on phasing-in changes given the scale and scope of disturbance that will occur in the supply market. In this context the impact assessment is wholly qualitative based on broad assertion. We propose that the approvals should be conditional upon phasing the changes in over two years, specifically through implementation of a cap on increases to worst affected customers at least over the first two years.

The reasoning provided by Ofgem behind the decision not to phase is not convincing:

- no phasing methodology has been scoped, and this is the sole reason why this "might not be consistently applied";
- cost-reflectivity is one of the relevant objectives but so is the need to avoid distortions in the competitive market. It is clear that non-national suppliers will face a lottery given the extent of the changes that will occur, harming competition;
- cross-subsidies will continue and in a number of cases where distributors proposals are incomplete or have not been persuasive to Ofgem, it is sanctioning their continuation; and

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- given the depth of the work submitted by the DNOs it is not correct to say that phased implementation will make it more difficult for future changes to be scoped. It is also possible that future changes sign-posted could erode some of the change impacts that will arise in April 2010.

It is also erroneous to assert that:

- changes have been signalled in advance to customers. Distributors have only just begin to communicate outside of specialist industry forums how individual consumer's charges might change and the figures have yet to be finalised;
- as we have noted in the cover letter, both the variability and volatility of indicative charges proposed to date have been exceptional suggesting that the numbers presented in the impact assessment cannot anyway be relied upon;
- there has been until recently no guarantee of delivery of the project, as evidenced by the further slippage to the implementation of EHV charges and the quantum of the changes has not been foreseeable; and
- as noted distributor communication has been partial and in many instances half-hearted, falling well-short of what is required particularly given general consumer confusion over current pricing levels.

Put at its simplest most consumers (those on the domestic unrestricted and domestic two rate arrangements) will face average bill impacts of increases of between 1-2% and Ofgem seems to be relying on the fact that the overall increase is relatively small. However these average numbers are twice the level it indicated as arising from its initial DPCR proposals, and there remains significant uncertainty over how the indicative increases will translate into costs on final bills. The range around these averages is also wide with some consumers likely to see increasing bills of some 5%. These increases are due to be implemented at a time of other expected increases in the non-energy element of consumer's bills and will inevitably compound the problems faced by vulnerable customers.

As the industry and its regulator has a large degree of control over the nature of these changes and the timing of their implementation, all reasonable steps should be taken to mitigating and smoothing the effect on consumers' bills.

Question 3: Do you consider any element of the methodology would warrant an overall vetoing of the DNOs' common methodology submission?

No, it is the accumulative effect that is the primary concern combined with the significant variations that will occur between different customer classes and between regions for customers in the same customer class.

Question 4: Are there any additional areas you would like to flag as areas you consider warrant further work by DNOs in the future?

We have no further issues on the technical aspects of the methodology.

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We do have concerns about the efforts being directed by distributors at customer communications strategies given the extent of likely change that customers will see from April 2010. We do not believe that they have done “all they can to keep their customers updated on the impact of their charges.” Ofgem has noted that “not all DNOs have made the same level of commitment regards communicating the impact of the changes”, and we believe there is significant further work to be done by the DNOs in this area.

We are also nervous about the emphasis placed on the use of industry governance processes before they have been defined. It took DCUSA governance the greater part of a year to get into its stride following designation, and its extension to network charging has yet to be approved.

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