Regulation & Commercial

Rachel Fletcher
Director, Distribution
Ofgem
9 Millbank
London
SW1P 3GE

Your ref

Our Ref

Date
07 October 2009

Contact / Extension
María Isabel Liendo
01698 413512

Dear Rachel,

Request for a derogation under part J of standard licence condition 50 of the distribution licence.

In accordance with Part J Standard Condition 50. (Development and implementation of a Common Distribution Charging Methodology), of the Distribution Licence, SP Energy Networks, on behalf of its two Licensed Distribution Network Operators (SP Distribution Ltd and SP Manweb plc) is seeking a *definite* derogation from Paragraph 50.13 of Part C of the Condition, as per the details provided below.

Details of the applicant

Applicant:	Scott Mathieson, Regulation and Commercial Director
Licensees:	SP Distribution Ltd Registered Office: 1 Atlantic Quay, Glasgow, G2 8SP SP Manweb plc Registered Office: 3 Prenton Way, Prenton, CH43 3ET

Description of non-compliance

Condition 50.13 requires the implementation of the Common Charging Methodology the "CDCM" by the Implementation Date (1 April 2010). SP Energy Networks expects that on 1 April 2010 it will not be able to comply with some aspects of the tariff application requirements, detailed in Appendix 1 to this letter. The changes to the billing systems require to be adequately tested and implemented and SPEN is working with our current billing system supplier to establish detailed requirements, as well as starting to consider other options for system supplier for a billing system which is fully compliant with the CDCM. We consider that these changes will be ready for implementation by April 2011. Nevertheless, we will make reasonable endeavours to implement sooner if possible.

Impact of the non compliance on:

- **Consumers and competition.**

  Consumers will be impacted on the areas of DUoS tariffs detailed in Appendix 1 to this letter, to the extent that electricity suppliers decide to "pass on" the charges into the final electricity bill. See Appendix 1 for the detailed impact of each area where derogation is sought.

- **Sustainable development and Health and Safety.**

  We do not believe that there is an impact on sustainable development or health and safety.

- **Other parties.**

  The main party impacted by these issues is electricity suppliers, as they will see a delay in the implementation of the CDCM. Please note that the effect of this derogation will in effect maintain the "status quo" for DUoS tariff application in the areas detailed in Appendix 1.

Appendix 2 to this letter highlights two further areas of risk for which we are not seeking derogation at this moment, but that we feel it is important to draw attention to. We plan to keep those areas under review prior to implementation.

Please do not hesitate to contact me should you need any further information.

Yours sincerely,

pp Scott Mathieson
Regulation and Commercial Director

New Alderston House, Dove Wynd, Strathclyde Business Park, Bellshill, ML4 3FF

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Appendix 1. Details of SPEN's request for derogation from the CDCM.

Description of non-compliance	Reasons for non-compliance	Impact on Customers and Competition	Proposal for restoring compliance	Mitigation action	Duration of the derogation
Exceeded capacity charges – Application of excess capacity charges for a month only	Our billing system currently charges exceeded capacity for a financial year, backdated to the previous April. SPEN will not be able to implement and fully test the required changes to the billing system by April 2010.	Only customers that exceed capacity would be impacted by this. The estimate number of customers that "breach" their authorised capacity in a 12-month period is circa 2.8 k in total for both licensed areas (based on FY 08-09), out of a total of 3.6 million. We do not think this derogation has a significant impact on competition.	We are working with IBM to establish detailed specifications for system changes, implement the required changes and undertake adequate testing and user acceptance to ensure continued accuracy of DUoS billing. We anticipate the necessary changes to the billing system, including testing and verification checks, to be complete by April 2011.	We intend to continue charging using the current methodology and billing system, without system changes.	12 months, to April 2011.
Capacity kVA calculation	Our billing system uses a slightly different formula for calculating kVA. For demand customers, the CDCM formula uses: $\text{Import Demand} = 2 \times \sqrt{\text{AI}^2 + \max(RI, RE)^2}$ whereas SPEN's current method uses: $\text{kVA} = 2 \times \sqrt{(AI)^2 + (RI)^2}$ For generation customers, the CDCM formula uses: $\text{Export Demand} = 2 \times \sqrt{\text{AE}^2 + \max(RI, RE)^2}$ whereas SPEN's current method uses: $kVA = 2 \times \sqrt{(AE)^2 + (NetReactive)^2}$ SPEN will not be able to implement and fully test the required changes to the billing system by April 2010.	Only **demand** customers that exceed capacity would be impacted by this. The estimate number of customers that "breach" their authorised capacity over a 12-month period is circa 2.8 k in total for both licensed areas (based on FY 08-09), out of a total of 3.6 million. Generation customers are not impacted, as the CDCM does not charge generators on a kVA basis. We do not think this derogation has a significant impact on competition.	We are working with IBM to establish detailed specifications for system changes, implement the required changes and undertake adequate testing and user acceptance to ensure continued accuracy of DUoS billing. We anticipate the necessary changes to the billing system, including testing and verification checks, to be complete by April 2011.	We intend to continue charging using the current methodology and billing system, without system changes.	12 months, to April 2011.

Description of non-compliance	Reasons for non-compliance	Impact on Customers and Competition	Proposal for restoring compliance	Mitigation action	Duration of the derogation
Excess reactive charges	Our billing system uses a slightly different formula for calculating the chargeable kVArh. For demand customers, the CDCM formula uses: $\mathrm{Chargeable kVArh} = \max(\max(\mathrm{RI}, \mathrm{RE}) - (0.33 \times AI), 0)$ whereas SPEN's current method uses: $ChargeablekVArh = RI - (0.33 \times AI)$ For generation customers, the CDCM formula uses: $\mathrm{Chargeable\ kVArh} = \max(\max(\mathrm{RI}, \mathrm{RE}) - (0.33 \times AE), 0)$ whereas SPEN's current method uses: $ChargeablekVArh = NetReactive - (0.33 \times AE)$ SPEN will not be able to implement and fully test the required changes to the billing system by April 2010.	Only customers that exceed the power factor threshold would be impacted by this derogation. The estimate number of customers that pay reactive charges in our licensed areas over a 12-month period is circa 5.9 k in total for both licensed areas, out of a total of 3.6 million. We do not think this derogation has a significant impact on competition.	We are working with IBM to establish detailed specifications for system changes, implement the required changes and undertake adequate testing and user acceptance to ensure continued accuracy of DUoS billing. We anticipate the necessary changes to the billing system, including testing and verification checks, to be complete by April 2011. The requirement to make the changes for multi-site billing makes the solution significantly more complex.	We intend to continue charging using the current methodology and billing system, without system changes.	12 months, to April 2011.

Appendix 2. Further areas of risk.

SPEN has identified two further areas of risk for which we are not seeking derogation at the moment, but that we feel it is important to inform our customers about.

1. VAT on generators tariffs.

This was highlighted as an area of general risk for all DNOs in the CDCM submission. There is uncertainty as to whether negative charges to generators are classed as one or two supplies which may result in either generators or suppliers producing a bill rather than the distributor, or the distributor having to raise a "self bill".

Our current view is that it is a continuous supply because there is positive and negative charges contained within the tariff and this is one of many tariffs offered to the supplier to their customer. The industry approach is that we bill the supplier for use of the network because it is the supplier that takes title to the electricity being transported across our network. The generator is 'using' the network through a supplier in both directions through one set of connection equipment.

However, there is a risk that the DNOs will get an external steer in relation to considering this as two supplies, which would have an impact on our billing systems. We are working with other industry participants to mitigate the risks and prepare the case to support our current view.

2. Portfolio billing.

This was highlighted as an area of general risk for all DNOs in the CDCM submission. The approach to LDNO tariffs and the processing of data to support the tariffs are still under development by the industry and as such an IT solution cannot be specified to the DNO's service provider. Some industry participants have indicated that they anticipate this could take up to 18 months to complete.

DNOs will be working together with the IDNOs in the coming months on an "interim" implementation of the CDCM LDNO tariffs until the IT solution is fully implemented, possibly under an Ofgem chaired group.