



Company Secretary
Central Networks
Westwood Way
Westwood Business Park
Coventry
CV4 8LG

*Promoting choice and value for
all gas and electricity customers*

Direct Dial: 020 7901 7194
Email: rachel.fletcher@ofgem.gov.uk

Date: 31 March 2010

Dear Company Secretary

Revocation of derogation granted pursuant to paragraph 50.36 of Standard Licence Condition 50 (Development and implementation of a Common Distribution Charging Methodology) of the Electricity Distribution Licence

The common distribution charging methodology (CDCM) is being implemented from 1 April 2010. On 21 December we granted Central Network's (CN¹) request² for a derogation against full implementation of the CDCM from 1 April 2010 in respect of the requirement to comply with the CDCM in relation to the calculation of chargeable reactive power units until expiry of the derogation on 30 September 2010³.

On 17 February CN notified DCUSA parties that it does not require the derogation and it intends to apply the new CDCM in full from 1 April. On 18 March 2010 CN formally requested that the Authority revoke their derogation. This formal request is in line with paragraph 50.36 of the distribution licence, which specifies that derogations relieve a licensee of its obligations to such extent, for such period of time, and subject to such conditions as may be specified in the direction. Our December letter directed that the derogation will expire on 30 September 2010 unless amended or revoked by the Authority upon reasonable notice.

Granting of CN's original derogation request

CN set out in their request for a derogation that they could not comply with the CDCM from 1 April 2010 due to billing system constraints:

"The reason for this non-compliance lies in our current site-specific billing system, and is of an interim nature. We are advised that modification of the current system to overcome issues over the billing of charges for excess reactive power, while technically possible, is likely to cause severe system performance issues that will put at risk our ability to produce half-hourly bills. This would clearly be unacceptable to both suppliers and ourselves, and we do not therefore propose to make this particular modification to the system.

The non-compliance will be permanently resolved with the implementation of a new billing system, planned to be operational by April 2011."

¹ This letter refers to CN East and CN West.

² CN's derogation request is published on our website at <http://www.ofgem.gov.uk/NETWORKS/ELECDIST/POLICY/DISTCHRGs/Documents1/Derogation%20application%20-%20billing%20system.pdf>.

³ <http://www.ofgem.gov.uk/Networks/ElecDist/Policy/DistChrgs/Documents1/CN.pdf>.

In our decision to grant CN's original derogation request we indicated that the duration of this derogation would be shorter than the 12 months requested by CN. Our decision to reduce the duration of the derogation from 12 to 6 months was influenced by discussions with suppliers and licensees, and by the duration of derogation requests on similar issues submitted by other licensees.

In a letter to the industry giving an overview of derogations granted across DNOs⁴ we explained that we considered that the derogations we granted do not undermine the benefits being delivered by the introduction of the common methodology. We further commented that except for one derogation, all derogations were granted for a period of 6 months to have a uniform expiry date and thereby ensure maximum transparency of the derogation process and minimum cost for suppliers, as well as to tie in with normal charge change processes where it is expected that DNOs change their charges on either 1 April or 1 October each year.

CN's request for revocation

We have considered CN's request for their original derogation request to be revoked where CN states:

"[W]e requested and were granted derogations against both our licences in respect of reactive power charging under the CDCM. In the event we have been able to remove the need for these derogations by modifying our half-hourly billing system, and will be fully compliant with the CDCM from 1 April 2010.

We have been clear in our communications with Ofgem and with stakeholders that we would endeavour to overcome the non-compliance ahead of implementation of the CDCM, and finally confirmed that we would be fully compliant from 1 April 2010, when we gave notice of our final tariffs on 17 February this year.

We received no push-back from suppliers on this, whatsoever.

We believe that full compliance with the CDCM from the start is a desirable outcome that will be welcomed by suppliers."

The Authority's decision

We are content to revoke the original derogation for the following reasons:

- CN is now able to implement the CDCM in full from 1 April 2010. Over both its distribution areas about 1.5% of half hourly customers' revenue will come from reactive charges. Under the original derogation CN would have slightly undercharged these customers in comparison to the CDCM by less than 5 pence per MPAN per year through cross subsidisation.
- Our understanding is that CN, in modifying its billing system would not in any case be able to implement the derogations granted now that the new billing system is in place because a manual work around would involve considerable resources at too high a cost to justify this approach given its very modest impact on customers.
- CN state it has not had any push back from suppliers on this matter. Suppliers have not raised any concerns with us over this revocation.
- The revocation of this derogation does not impact on security of supply, competition, sustainable development or health & safety.

This letter constitutes notice for the purposes of section 49A of the Act.

⁴ <http://www.ofgem.gov.uk/Networks/ElecDist/Policy/DistChrgs/Documents1/summaryletter.pdf>.

Yours faithfully

Rachel Fletcher
Partner - Distribution
For and on behalf of the Authority