



Geoffrey Randall
The Office of Gas and Electricity Markets
9 Millbank
London
SW1P 3GE

98 Aketon Road
Castleford
West Yorkshire
WF10 5DS

Tel: (01977) 605912
e-mail: Harvey.jones@ce-electricuk.com

16 May 2011

Dear Geoffrey

The purpose of this letter is to inform you about a discrepancy in the input sheet to the NEDL April 2011 charging models, to quantify the issue and to inform you of our proposed resolution.

Background

Indicative charges for April 2011 were communicated by NEDL to Ofgem and suppliers on 23 December 2010 in line with the three-month notice period required by the distribution licence. Final charges were then communicated on 18 February 2011 in line with the formal 40-day notification period required by the distribution connection and use of system agreement (DCUSA). These charges came into force on 1 April 2011. All charges were based on the common distribution charging methodology (CDCM).

When both the indicative and final charges were published, Ofgem and suppliers were informed and copies of the actual charging models were posted on the CE website.

Since then we have become aware that, despite our efforts to ensure the accuracy of the charges models, there was an error in the model inputs for LV circuit losses in both the indicative and final charges models for NEDL. Our model currently has a LV circuit losses value of 1.008 and the correct value should be 1.086. The error has occurred due to an incorrect link in the input data to the models whereby the losses value for the LV circuit (1.008) was linking to the value for 132/EHV and not LV circuits. This does not affect the overall revenue recovery, but rather the recovery proportions from different customer groups: as you will appreciate, changing any input to the common distribution charging methodology

CE ELECTRIC UK FUNDING COMPANY

Registered Office: Lloyds Court, 78 Grey Street, Newcastle upon Tyne, NE1 6AF

Registered in England and Wales. Registered Number: 3476201

If you would like an audio copy of this letter, a copy in large type, Braille or another language, please call 0800 652 6543

has an impact on all tariffs, not just those for any specific customers. We have rechecked the equivalent inputs for the YEDL model and are satisfied that these are correct.

Impact and sensitivity analysis

The table below shows the impact on overall annual revenue, for the core demand tariffs, of correcting the input value for the LV network losses in the charge setting models (i.e. changing the LV network losses from 1.008 to 1.086). This clearly demonstrates that the overall annual revenues effectively do not change, but that the distribution of the revenue recovery does. In fact the proportion of revenue recovery decreases for the higher-voltage customer groups (i.e. LVSub, HV and HVSub) and increases for all LV customer groups.

Core Demand tariffs	Published 2011/12 charges (£m/year)	Revised 2011/12 charges (£m/year)	% Variance	Number customers	% customers	Level of annual over(+)/under(-) charge (£)
Domestic Unrestricted	117.1	118.0	0.8%	1,355,748	85.2%	-0.70
Domestic Two-Rate	9.4	9.5	0.5%	100,647	6.3%	-0.51
Domestic Off-Peak (related MPAN)	0.4	0.4	4.1%	24,315	1.5%	-0.72
Small Non-Domestic Unrestricted	17.0	17.3	1.2%	71,211	4.5%	-2.93
Small Non-Domestic Two-Rate	5.9	6.0	1.5%	16,580	1.0%	-5.26
Small Non-Domestic Off-Peak (related MPAN)	0.0	0.0	2.5%	806	0.1%	-1.25
LV Medium Non-Domestic	19.8	20.1	1.5%	15,650	1.0%	-18.71
LV Sub Medium Non-Domestic	0.6	0.6	-5.8%	273	0.0%	+135.81
HV Medium Non-Domestic	0.1	0.1	-6.6%	40	0.0%	+220.70
LV HH Metered	36.9	37.5	1.7%	4,193	0.3%	-145.56
LV Sub HH Metered	0.1	0.1	-6.5%	18	0.0%	+204.66
HV HH Metered	34.7	32.5	-6.3%	712	0.0%	+3065.47
HV Sub HH Metered	0.0	0.0	-7.3%	5	0.0%	+148.44
NHH UMS	5.2	5.2	1.5%	1,391	0.1%	-54.98
LV UMS (Pseudo HH Metered)	0.1	0.1	1.2%	4	0.0%	-216.98
Total	247.4	247.4		1,591,592		

Correcting the discrepancy in the model would mean an average annual reduction in revenue recovery across the higher-voltage customer groups via a decrease in charges of 6.3% (i.e. revenue recovery from these groups moving from £35.5m to £33.3m). Conversely this would mean an average increase in revenue recovery across the lower-voltage customer groups via an increase in charges of 1.1% (i.e. revenue recovery from these groups moving from £211.8m to £214.1m).

Correcting the charge setting model would mean an average annual increase in charges for a domestic unrestricted customer of circa £0.70 per customer. So far as the balancing reduction in charges is concerned, the customer group affected to the greatest extent would be the high-voltage half-hourly metered customers, who would see an average annual reduction of £3,065.47 per customer by correcting the error in the charge-setting model.

In terms of the effect on customers, correcting the error would, if fully reflected in a revision of suppliers' charges, result in 0.1% of end users seeing a decrease in charges and 99.9% facing an increase.

Proposed solution

Paragraph 14.4 of standard condition 14 of the electricity distribution licence states that

'The licensee must periodically review the information set out in any Charging Statement available under paragraph 14.1 and, at least once in every Regulatory Year, must make any changes that are necessary to that statement to ensure that such information continues to be accurate in all material respects'.

CE wishes to correct this error as quickly as possible within the constraints of the electricity distribution licence and DCUSA.

Under standard condition 14 of the electricity distribution licence we need to provide at least three months' notice of a change in charges, albeit that we could ask for the Authority's consent to shorten this notice period.

Under DCUSA we must give 40 days' notice to change our charges and we must use reasonable endeavours to vary charges no more than twice in a year; and to implement them from 1 April or 1 October.

Given that the magnitude of the error over the first six months of the regulatory year will be circa £1m, which is significantly less than 1% of allowed revenues (the amount that we traditionally refer to as the materiality threshold), we do not propose to request a derogation from the three-month notice period, and we also intend to adhere to the 1 October implementation date preferred under DCUSA. This will provide the maximum amount of notice to suppliers. Proceeding thus will also allow us to factor in the correction of any other variances in the forecast under/over-recovery position at the end of 2011/12.

We are mindful that simply correcting the error at the mid-year stage would do nothing to address the imbalance in appropriate recovery across different customer groups, but merely

stop it getting worse. To resolve the issue fully and correctly, therefore, we propose not only to correct the error in the model going forward, but also to make some further adjustments to the charges for the second half of the year so that, by the end of the regulatory year, the revenue we have received in respect of each customer group will be as it would have been if the error had not occurred.

The current approved CDCM model held within DCUSA does not make provision for a mid-year tariff change without manipulation. There is a change proposal (DCP088 - Mid Year CDCM Charging Model) presently going through the DCUSA modification process to introduce a model that will assist in a part-year change to charges, but this will not be in place in time for a notification at the end of June. Hence, under paragraph 14.2 of standard condition 14 of the electricity distribution licence, detailed below, we believe, that strictly speaking, we need the Authority's consent to calculate charges that deviate from the methodology.

'Except with the Authority's consent, the Charging Statements available under paragraph 14.1 must:

(a) in the case of the Use of System Charging Statement, be prepared in accordance with the relevant Charging Methodology within the meaning of standard condition 13 (Charging Methodologies for Use of System and connection), standard condition 13A (Common Distribution Charging Methodology), or standard condition 13B (EHV Distribution Charging Methodology) (as appropriate); and

(b) in the case of the Connection Charging Statement, be prepared in accordance with the relevant Charging Methodology within the meaning of standard condition 13 (Charging Methodologies for Use of System and connection).'

Conclusion

Despite our efforts to ensure the accuracy of the inputs to the charging models, we have a confirmed error in the model inputs for LV circuit losses in both the indicative and final charges models for NEDL (we have rechecked the equivalent inputs for the YEDL model and are satisfied that these are correct. Our NEDL model currently has a LV circuit losses value of 1.008 and the correct value should be 1.086.

CE wishes to correct this error as quickly as possible within the constraints of the electricity distribution licence and DCUSA.

Given that the magnitude of the error over the first six months of the regulatory year will be circa £1m, which is significantly less than 1% of allowed revenues (the amount that we traditionally refer to as the materiality threshold), we do not propose to request a derogation from the three-month notice period, and we also intend to adhere to the 1 October implementation date preferred under DCUSA. This will provide the maximum amount of notice to suppliers. Proceeding thus will also allow us to factor in the correction of any other variances in the forecast under/over-recovery position at the end of 2011/12. Our preferred option would be to correct the error in the model going forward and make some further adjustments to charges for the second half of the year so that, by the end of the regulatory year, the revenue we have received in respect of each customer group will be as it would have been if the error had not occurred.

It may be relevant to Ofgem's consideration of the proposals in this letter that quite independently of the issue addressed in this letter, we are also currently evaluating whether it will be appropriate to introduce a mid-year tariff change, in both NEDL and YEDL, to manage the levels of over/under-recovery at the end of 2011/12.

Given that the current CDCM model held within DCUSA does not make provision for a mid-year tariff change without manipulation, we are requesting the Authority's consent, under paragraph 14.2 of standard condition 14 of the electricity distribution licence, for both NEDL and YEDL to calculate any mid-year revision of charges that we may deem necessary for over/under-recovery correction purposes based on a manipulated version of the CDCM charging models. Such consent is also requested with regard to the correction of the error in the NEDL model.

We think it would be helpful in the circumstances for us to meet with you to discuss this issue and give you a chance to ask questions ahead of addressing our consent requests, and to that end we shall contact you to discuss a convenient date: in the meantime, if you have any immediate questions please feel free to contact me.

Yours sincerely

Harvey Jones

Harvey Jones

Head of Network Trading