To electricity distributors,
generators, suppliers, customers
and other interested parties

Promoting choice and value for all gas and electricity customers

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Dear Colleague

Consultation on the request from CE Electric UK (NEDL) to publish use of system (UoS) charges that are not in accordance with its charging methodology.

CE Electric UK (CE) owns Northern Electric Distribution Ltd (NEDL), which is authorised by a licence to operate an electricity distribution business in the north of England. On 16 May 2011, CE wrote to Ofgem in relation to its NEDL licence requesting consent to deviate from its charging methodology in order to correct an error in charging. They followed up with a second letter, on 2 June 2011, in response to our request for further details.[1]

CE's request and this consultation do not concern the other electricity distribution network owned by CE, Yorkshire Electricity Distribution Ltd (YEDL).

In their letter, CE explained that they had recently become aware of an error in the calculation of use of system (UoS) charges based on the Common Distribution Charging Methodology (CDCM).[2] The error arose due to an incorrectly entered value for low voltage (LV) circuit losses in both the indicative and final charges model for NEDL. They explained that the error does not have an impact on the overall revenue recovery for NEDL but does affect the amount of revenue recovered from each customer group. If left unfixed the error will result in some customer groups, in particular non-domestic customers, being significantly over-charged in 2011-12. The impact of the error on domestic customers (who make up the largest proportion of CE's customers) is much less significant, with an average domestic customer facing a very small under-charge of around £0.70, in 2011-12.

CE proposed a solution to correct the identified error and also to rebalance their UoS charges so that, by the end of the 2011-12 charging year, customers will have paid what they would have paid if no error had been made. The proposal would result in a change in UoS charges from those published in April 2011, with the change due to take effect from the mid-year point on 1 October 2011.

In order to implement their solution, CE has asked the Authority for its consent to publish UoS charges that are not calculated in accordance with the 'relevant charging methodology' (the CDCM). This request is in accordance with standard licence condition (SLC) 14.2 of the electricity distribution licence.

As we set out in more detail below, we are sympathetic to the principle behind CE's request, namely that its customers should so far as possible be put in the position they

[1] CE's letters are published on the Ofgem website as associated documents to this consultation letter.
[2] The CDCM is the methodology used by distribution network operators to calculate use of system charges for customers connected to the high voltage (HV) and low voltage (LV) networks.

would have been in if no error had been made. This consultation letter therefore seeks views from interested parties on CE's proposed solution and our preliminary views.

We recommend reading CE's letters to understand the background, the general impact of the error they have identified, and the effect of their proposed solution.

CE's proposal

CE proposes to correct the error they have identified and rebalance charges for the remainder of the 2011-12 charging year so that customers' total annual charge is correct: in other words, to put them in the position they would have been in if no error had been made. We note that CE also propose making changes to their UoS charges to take account of updated volume and target revenue allowance forecasts.

Correcting the error and updating the model - that is setting future charges at the correct level - does not require Authority consent.

Rebalancing charges to undo the effect of a past error would, however, require the charges to deviate from the requirements of the CDCM. In order to do this CE requires the Authority's consent. In further correspondence with CE they have explained to us in detail how they propose to make this manual adjustment.

In summary, CE's proposal to rebalance charges would involve recalculating the April 2011 tariffs under the assumption that no error had been made, then calculating the variance between the new tariffs and the original tariffs. A separate forecast of volumes for the first and second half of the year would be derived, based on the latest available information. An under/over-recovery of revenue for each tariff element, and for each customer group, would be calculated based on volumes for the first half of the year and the variance between the new and original tariffs. The adjustment required to each tariff in order to rebalance charges would then be calculated by dividing the revenue over/under-recovery in the first half of the year by volumes forecast for the second half of the year.

Impact on charges

As stated above, CE has requested consent to rebalance charges over the second six months of the charging year, from 1 October 2011. Our analysis below uses data provided by CE. As stated in CE's letter of 2 June 2011 "the information must only be considered to be illustrative of an expectation at a point in time (i.e. today)". Therefore, they should not be viewed as the final tariffs from which charges will be calculated from October 2011.

Analysis by CE indicates that the impact of the error on UoS charges varies significantly between different customers groups. Overall revenue collection by CE has not been materially affected by the error, but some customers are being over-charged, while others are being under-charged.

A comparison between charges that are only updated for the latest view of volumes and target revenue allowances, and charges that also correct the error so that going forward charges are properly calculated, shows that the average impact of the error on UoS charges for high voltage (HV) customers is an over-charge of 6.4%. That is, if the error is left uncorrected, HV customers will be over-charged on average by 6.4% by the end of the charging year. Conversely, due to the error an LV customer will on average be under-charged by 1.1% by the end of the current charging year. For domestic unrestricted customers (who make up around 85% of NEDL's customers) this equates to an average under-charge of £0.70 if the error is not fixed. The most materially affected group are HV half-hourly metered customers who face an annual over-charge of £3,290 on average, if the model is not corrected at the mid-year point.

We think that correcting this error at the mid-year point is beneficial to customers. If this error is corrected, the under/over-recoveries to which each customer group will be exposed

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will be around half the magnitude given above. The final impact on customers will be dependent on the contract that they hold with suppliers. Those on fixed term contracts may not see any change in their charges from 1 October 2011.

If we grant consent for CE to rebalance charges to correct for the error retrospectively as well as going forward, by the end of the charging year customers will have paid the UoS charges that they should have paid had the error not occurred. For example, if all else was held constant, a domestic unrestricted customer would by the end of 2011-12 on average see a charge of £87.10 compared to the charge they currently face of £86.40.

Details of NEDL tariffs under four scenarios can be found in the annex of CE's letter dated 2 June 2011. We reiterate that these tariffs are illustrative and may not represent the final tariffs used to calculate charges from 1 October 2011.

Our initial view

We are sympathetic to the principle behind CE's request, and at this stage are minded to grant consent to CE to amend its UoS charges to rebalance customers' charges over the last six months of the charging year. This would result in customers' final charges over the course of the 2011-12 charging year being the same as if no error was made. At this stage it appears to us that the effect of such a rebalancing will be in the interests of the majority of consumers affected by the error made by CE when setting original charges for 2011-12.

Our analysis of CE's proposed solution suggests that it is robust and can be implemented so that the publication of revised UoS charges takes effect at the mid-year point in October 2011.

We note that this is not the first error in UoS charges made by an electricity distribution network this year. We are concerned over the increasing number of errors that are occurring and the effect they have on the volatility in charges that suppliers and customers face. We are investigating whether there is a need to introduce new licence conditions for the electricity distribution networks, to put in place suitable arrangements for dealing with such errors. We will consult on this separately later in the year.

Next steps

We welcome views on our initial view to grant consent to CE's request. Please provide responses to this consultation by **15 July 2011**.

In accordance with SLC 14.11 of the electricity distribution licence, CE is required to give three months notice of any amendments to their UoS charges. To introduce new charges from 1 October 2011, notice of amended UoS charges must therefore be given by 30 June 2011. As this consultation will still be open, we will request that CE give formal notice both of the changes it intends to make if that consent is granted, and the changes it intends to make if it is not.

After the close of this consultation, we will look to make a decision in time to allow CE to meet the 40-day notification period, ie 22 August 2011, to make any appropriate UoS charge changes in compliance with DCUSA.[3]

Please email responses to Nicholas.Rubin@ofgem.gov.uk. Unless clearly marked as confidential, responses may be published on our website. If you have any queries in relation to this consultation please contact Nicholas Rubin on 020 7901 7176.

[3] DCUSA (Distribution Connection and Use of System Agreement) is a multi-party contract between the licensed electricity distributors, suppliers and generators.

Yours sincerely

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