



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

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

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

Date: 11 August 2011

Dear colleague,

Decision in relation to a request by CE Electric UK (NEDL) to publish Use of System (UoS) charges that are not in accordance with its charging methodology

On 17 June 2011, Ofgem published a consultation letter entitled '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' (Ref 79/11).¹ The consultation sought views from industry on a proposal by CE to correct an error it had identified by calculating its UoS charges in a different manner to the approved Common Distribution Charging Methodology (CDCM).

In particular, CE's proposal is intended to correct the error made in its UoS charges published on 1 April 2011 and rebalance charges from 1 October 2011 so that by the end of the charging year they will have recovered the correct amount of revenue from each of their tariff groups, as though no error had been made in the first place.²

Having considered CE's proposal and responses to our consultation, we have decided, in accordance with standard licence condition (SLC) 14.2, to grant CE a limited consent to calculate UoS charges in a manner other than in accordance with their relevant Charging Methodology (ie the CDCM). In particular, our consent means that CE will only be allowed to calculate UoS charges as they have proposed in order to correct and rebalance UoS charges to take effect from 1 October 2011.

Consultation and responses

We received seven responses to our consultation.³ Four responses were made by DNOs and three were made by suppliers.

There was some support by DNO respondents for CE's proposal. They considered that CE's proposal was on balance most appropriate for consumers because it would have the least impact on consumers and would have the effect of resolving the error sooner rather than later.

However, there was more general concern that DNOs have recently been making a number of errors when calculating UoS charges. One supplier explained that whilst they understood CE's desire to correct the error, it may become unsustainable for their business if DNOs

¹ See

<http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=695&refer=Networks/ElecDist/Policy/DistChrgs>

² A detailed summary of CE's proposal can be found in our consultation letter and its associated documents. See footnote 1.

³ All non-confidential responses can be found as associated documents to our consultation letter. See footnote 1.

continued to make errors. Suppliers argued that DNOs should scrutinise their charge changes in more detail to minimise the risk of further errors. Also, if errors are made, then DNOs should give a more reasonable amount of notice, eg DNOs should wait until the beginning of the next charging year.

A couple of respondents questioned whether any correction made by CE would be passed on directly to customers. This is because suppliers' contracts with customers do not always contain pass-through terms that allow the supplier to immediately pass through any changes in UoS charges.

Respondents also noted that it would be preferable for changes to charges to be made in accordance with the CDCM and associated DCUSA arrangements for making changes to charges. This would be beneficial because using existing processes is more transparent and facilitates certainty. Furthermore, CE's proposal could set an unhelpful precedent that makes unwinding future errors and rebalancing UoS charges potentially very complex.

Our decision

In accordance with SLC 14.2, we have decided to grant CE a limited consent to calculate charges not in accordance with the CDCM. This limited consent allows CE to make a one-off manual adjustment to their UoS charges, as they have set out in correspondence to us, to take effect from 1 October 2011.

We have decided to grant CE consent on this occasion because we consider that it is important for them to correct the identified error and rebalance their UoS charges sooner rather than later. This is because we think that, where it is possible, customer groups should not be unnecessarily over- or under-charged for their use of CE's network. Not correcting this error would mean that some half-hourly (HH) non-domestic customers are overcharged by approximately £3,000 for their annual use of CE's network. Not rebalancing UoS charges would mean that whilst the error was corrected prospectively, customers' overall annual charge would still be more or less than they would have paid had the CDCM been applied without error. For example, simply correcting the error would mean that a midyear price change would still mean the aforementioned HH customers will have been significantly overcharged for the first six months of the charging year.

We note concerns raised by some respondents that any changes to charges made by CE will not necessarily be passed on to specific customers. This is because whilst the DNO corrects and rebalances its charges, they are billed to a supplier who may not be able to pass on any change because of the terms of its supply contract with an end customer. Our understanding is that suppliers' portfolios contain a variety of customers on pass-through and non-pass-through terms. Whilst domestic and small and medium sized enterprise (SME) customers are highly likely to have non-pass-through terms, larger customers (eg those most adversely affected by the error identified by CE) are more likely to have pass-through terms. Correspondence with some suppliers suggests that their portfolios consist of approximately 50 to 95 per cent of large non-domestic customers with pass-through terms. As such, whilst not all customers may see the benefits of CE's change in charges, we still consider that the effect on those that do have pass-through terms will be sufficient to justify rebalancing.

We share respondents' concerns over the number of errors being identified by DNOs. We note that the CDCM was only implemented in April 2010, therefore DNOs may still be 'bedding in' internal processes, and mistakes do happen from time to time. However we urge all DNOs to complete a full review of their quality assurance processes to ensure that they are fit for purpose and the risk of future errors is considerably reduced. It may be appropriate for parties to consider whether additional DCUSA obligations are needed to mitigate the risks of errors being made.

We note that CE have sought consent to correct and rebalance their charges because at present the CDCM does not allow them to make such changes as part of a midyear change

to charges. That is, the CDCM allows them to correct the error prospectively but not to rebalance their charges. We also note the number of errors that have been made by DNOs recently and the concerns raised by suppliers in relation to how DNOs mitigate the risk of errors and correct errors once they are identified. We consider that further thought should be given to developing appropriate arrangements that are in the interests of consumers by allowing DNOs to appropriately correct errors but that also take account of the costs borne by suppliers (and ultimately customers). We are investigating whether there is a need to introduce new licence conditions for the DNOs, to put in place suitable arrangements for dealing with errors and incentivising them to not make the errors in the first place.

Whilst we note the concerns raised by respondents, when compared to other recent errors corrected by DNOs, we think that the materiality of the specific error that CE propose to resolve is relatively low. Furthermore, in light of the current design of the CDCM we consider it is not unreasonable on this occasion for CE to seek the Authority's consent to make the changes they propose so their charges are corrected and rebalanced sooner rather than later.

Please contact Nicholas Rubin if you have any questions in relation to this decision letter. He can be contacted either on 020 7901 7176 or by email at nicholas.rubin@ofgem.gov.uk.

Yours faithfully,

A handwritten signature in black ink, appearing to read 'Rachel Fletcher', is written over a light grey rectangular background.

Rachel Fletcher

Partner, Distribution

Signed on behalf of the Authority and authorised for that purpose