To licenced distribution networks, generators, parties to DCUSA, suppliers, customers and their representatives, and other interested parties

Date: 8 August 2014

Dear stakeholder

Consultation on a proposal to increase significantly the notification period for changes to distribution use of system charges

Northern Powergrid has proposed a change to the Distribution Connection and Use of System Agreement (DCUSA). The change, known as DCP178, would increase the notice period for distribution use of system (DUoS) charges under DCUSA from 40 days to 15 months.

At the industry voting stage, DCP178 was rejected. However, most suppliers and DNOs who voted supported the proposal. The decision was submitted to us for a decision on 8 July 2014.

DCP178 would be a significant change. We have decided to consult on the proposal, to make sure that all affected parties are aware of it and have an opportunity to comment. We would also like to provide time for any further evidence to be submitted to us before we reach our decision. Given the significance of the change, we hope both advocates and those with concerns will respond to this consultation.

We have published the Final Modification Report and summaries of two consultations undertaken by the industry working group alongside this letter on our website. The other relevant documents, including the change proposal, are available on the DCUSA website (www.dcusa.co.uk).[1]

Please provide your response by email to bethany.hanna@ofgem.gov.uk by 19 September 2014.

Development of the modification

Distribution Network Operators (DNOs) are currently required to finalise and publish DUoS charges 40 days before the tariffs take effect. Northern Powergrid's proposal would extend the notice period to 15 months. This would apply to all DUoS tariffs whether derived from the common distribution charging methodology (for customers connected at low and high voltages) or the extra-high voltage distribution charging methodology.

[1] To access documents on the DCUSA website, you will need a password. Please contact Electralink via the website if you do not have access but wish to see these papers.

The working group and respondents to consultations have identified a number of benefits and costs of DCP178. We welcome views on these and any further evidence or other issues.

Benefits

The working group considers that increasing the notice period will increase the certainty of DUoS charges. Earlier notice of changes in tariffs will allow suppliers and customers to budget more accurately t for DUoS charges. You may also want to consider whether greater certainty of prices would improve the ability of smaller suppliers to compete in the supply market.

The working group also considers that DCP178 might reduce the charges some consumers pay under their supply contracts. For example, under non-pass through contracts, tariffs are fixed during the term of the contract and the supplier bears all the risk of changes in DUoS charges. This is reflected in a risk premium the supplier includes in charges under the contract. Extending the notice to 15 months may enable suppliers to reduce their risk premium.

We encourage you to consider whether there is any further evidence to demonstrate the likelihood of any reduction in DUoS charges (ie whether suppliers will pass on such benefits) and the magnitude of any such reduction for end customers.

Suppliers have also indicated that an extended notice period may allow them to introduce additional products, due to the lower risk. In particular, it may be possible for suppliers to introduce pass-through contracts for larger customers connected at extra-high voltages.

Costs and other effects

This proposal would increase significantly the implementation date for future modifications, compared to the current arrangements. One respondent to the second working group consultation raised concerns about the potential impact of this on independent distribution network operators (IDNOs). If a modification is approved in the future that increases the IDNOs' margins, the extended notice period would delay when they can start to benefit from the greater margin. This would have a negative effect on IDNOs because, unlike DNOs, they cannot recover retrospectively any revenue they did not receive during the implementation period.

You may also wish to consider the possible effect or cost of deferring implementation of changes relating to specific elements of the smart meter rollout or smart grid development. We would be interested in your views on the likelihood of a specific change, the potential lead time, and any costs or loss of benefits from any delay, if we were to approve DCP178. This issue is discussed further below.

The DNOs also noted that they were subject to penalties if they over or under recovered against their allowed revenue to a greater extent than is allowed for in their licences. Setting prices 15 months in advance increases the likelihood that they might exceed these parameters. However, several DNOs still voted to accept DCP178.

One DNO also suggested that setting charges 15 months in advance could affect the cost of capital for their business. This concern relates to the impact of the lagging of incentive revenue under RIIO-ED1 where a DNO has under-recovered against allowed revenue.

Questions:

- Do you agree with the working group's view that DCP178 would result in these benefits and costs?
- Are there any other benefits and costs that you think would result from DCP178?
- For suppliers and customers, can you provide supporting evidence for the benefits identified by respondents to the working group's consultations?

The Office of Gas and Electricity Markets
9 Millbank London SW1P 3GE **Tel** 020 7901 7000 **Fax** 020 7901 7066 **www.ofgem.gov.uk**

Further considerations

There are a number of challenges facing DNOs where there may be a link to changes to distribution charges. These include:

- the electrification of heat and transport;
- increases in local, renewable generation;
- mass rollout of smart meters to domestic premises;
- smart grid developments; and
- European-related developments.

To support some of the changes, up to £1 billion[2] of customers' money is potentially available between now and 2023 through our innovation mechanisms. This will help DNOs fund trials of innovative ways to address the forthcoming challenges. Extending the notice period of charge changes may delay new arrangements and reduce benefits for customers.

In the RIIO-ED1 draft determinations, we have proposed some tough cost efficiency targets for DNOs based on savings they can make through smart grids and LCNF projects.[3] To achieve these savings, DNOs may need to change their charging methodologies and commercial arrangements.

The roll-out of smart and advanced metering has the potential to create smarter energy markets that are more efficient, dynamic and competitive. However, these benefits for consumers will not be realised without changes to the market arrangements that underpin how market participants interact with each other and consumers. This could include changes to DUoS charging arrangements.

The link between smarter markets and DUoS charging arrangements has been underlined by initiatives that aim to use the opportunity that the roll-out presents to improve the accuracy, timeliness and efficiency of the electricity settlement process set out in the Balancing and Settlement Code (BSC). See for example BSC Modification P272, which proposed to mandate half-hourly settlement for larger non-domestic consumers

We think it is important that changes to market arrangements are delivered in a timely way to help realise the benefits of smarter markets.

Questions:

- Do you think the proposed notice period would cause any issues with implementing any changes to charges which may be required due to developments in the operation of the network?
- Do the benefits of certainty outweigh any costs or effects of delay?
- Can you give examples over the next five years of likely changes to distribution charges that are critical to deriving benefits but which would be delayed unduly if DCP178 was approved?

Next steps

The closing date for responses to this consultation is 19 September 2014. Once we have considered the responses, we will make our decision on DCP178.

[2] In the last distribution price control, we allocated up to £500 million for the low carbon network fund (LCNF). As part of ED1, we have proposed that the LCN Fund will form part of the Electricity NIC. The Electricity NIC is worth up to £90 million per year (across distribution and transmission) up to 2017. After 2017, we will review the funding available. In addition to the NIC, DNOs will have access to a fixed network innovation allowance. As part of the draft determinations for ED1, we propose an allowance of £200m from now until 2023.

[3] https://www.ofgem.gov.uk/ofgem-publications/89076/riioed1draftdeterminationoverview30072014.pdf

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All written responses should be sent by e-mail and preferably in pdf form to bethany.hanna@ofgem.gov.uk. We will publish all non-confidential responses on our website. If you do not wish all or part of your response to be made public, you should clearly mark your response as confidential. If you are submitting confidential material, it would be helpful if this could be confined to an appendix so that we can publish the main body of the response.

While we encourage you to make written submissions, we recognise that some parties may also want to meet with us to discuss the change proposal. Should you wish to do so, then please contact Bethany Hanna by email or on 0203 263 2771.

We look forward to hearing your views.

Yours faithfully

Andy Burgess

Andy Burgess
Associate Partner, Transmission and Distribution Policy

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