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Dear Bethany,

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

National Grid, through our subsidiary National Grid Electricity Transmission plc (NGET), owns and operates the electricity transmission system in England & Wales, and is the National Electricity Transmission System Operator (NETSO) for the entire transmission system across Great Britain. In our role as NETSO we have similar responsibilities to the electricity DNOs for setting network use of system tariffs which recover the allowed revenues of onshore and offshore Transmission Owners (TOs) whose assets comprise the National Electricity Transmission System (NETS). We are therefore interested in the perceived benefits of DCP178 (Notification Period for Change to Use of System Charges), and welcome this opportunity to respond to your consultation.

We recognise that customers value certainty in their charges, and that such certainty can help reduce any risk premium a supplier may pass on to the end consumer. Certainty may be increased through improving the transparency, predictability and timeliness of actual and forecast charges. Transparency is assisted through understanding of how charges are calculated and sources of potential volatility. Predictability improves the accuracy of forecasts and hence reduces the risk premium. Timeliness ensures suppliers have sufficient time to account for any changes to charges.

We understand that DCP178, through increasing the notification period for changes to distribution use of system (DUoS) charges, will improve the timeliness of electricity distribution charges and hence reduce any risk premium a supplier may pass on. However we believe that this proposal may also increase the risk of a DNO over or under recovering its allowed revenues; a risk that will increase under RIIO-ED1 due to the increased number of revenue elements based on incentives. This could result in increased volatility of charges. The full financial impact of these additional risks on the DNO and suppliers need to be considered alongside the aforementioned potential benefits to understand the overall impact on the end consumer. If DCP178 results in a net benefit for the end consumer then it would appear appropriate for the DNO to hold this additional risk, providing it is compensated for any additional financing costs. Indeed we believe that such mechanisms may be appropriate for

other network charging arrangements, although we recognise that such potential arrangements should be considered on a case by case basis. This approach appears consistent with the conclusion to Ofgem's volatility consultation under RIIO-T1

Risk premiums arising from charging uncertainty can be similarly managed through ensuring that network charges remain transparent, predictable and timely. The Transmission Network Use of System (TNUoS) Charging Methodology as laid out in Section 14 of the Connection and Use of System Code (the CUSC) specifically lays out a number of ways that we improve the predictability and stability of these charges. Recently we have also worked with stakeholders to provide more frequent and detailed information on our future charges to improve their predictability. This includes providing quarterly updates to our forecasts, more detailed revenue breakdowns, and timely five year forecasts. In transmission the recent changes to user commitment arrangements under CMP192 have had the effect of incentivising generation to provide network companies with advance notice of changes to access requirements. This timely provision of information also contributes to a more predictable tariff.

We believe that such mechanisms can bring about many of the desired benefits of DCP178 whilst retaining the flexibility of the current charge setting process, and at the same time avoiding the disadvantages of delays to the introduction of methodology changes when required.

In Annex 1 we provide further response to the specific questions raised in your consultation. However, if you would like to discuss any of these points further, please do not hesitate to contact me or Andy Wainwright (email: [andy.wainwright@nationalgrid.com](mailto:andy.wainwright@nationalgrid.com), tel: 01926 655944).

Yours faithfully

Patrick Hynes

## Appendix A – National Grid Electricity Transmission Responses to specific questions raised in consultation

In this annex we set out our thoughts on the specific questions raised in the consultation.

### Development of the modification

- *Do you agree with the working group's view that DCP178 would result in these benefits and costs?*

We understand that the perceived benefits of DCP178 follow from the increased certainty in DUOS charges. These include more accurate budgeting by both suppliers and consumers leading to reduced risk premiums, and potentially an improved ability for smaller suppliers to compete in the supply market. We believe that whilst these benefits may exist, it is important that the full costs to industry of this proposal are considered and quantified.

We agree with those parties who recognise that a DNO licence change would be required to alter the bandwidth of permissible over and under recovery of revenue. A similar increased error bandwidth was evidenced in the development of CUSC modification proposal CMP224 'Cap on the total TNUoS target revenue to be recovered from Generation Users' which suggested a 7% error margin in charge forecasts at 2 months notice increasing to around 14% at 12 months notice. We understand that up to 50% of this bandwidth may be due to revenue forecasts<sup>1</sup>.

In principle we believe that the DNO should be held neutral to the impact of this wider bandwidth particularly where changes are outwith of that DNO's control. There are a number of ways this could be achieved, and as a minimum this should involve post event recovery of financing costs. Any such consequential costs to industry need to be considered alongside any benefits through reduced supplier risk premiums.

- *Are there any other benefits and costs that you think would result from DCP178?*

Whilst we agree that DCP178 would increase the level of certainty of DUoS charges, we have concerns over its impact on longer term stability and hence predictability of these charges. This is because final allowed revenues for electricity DNOs under RIIO-ED1 will be determined annually and after the proposed date for final charge setting. This increases the probability and magnitude of over or under recovery of allowed revenue. Any shortfall or over-recovery would then be recovered in a future charge year, making charges more volatile due to financing costs.

- *For suppliers and customers, can you provide supporting evidence for the benefits identified by respondents to the working group's consultations?*

As neither a suppliers nor customer we are not able to provide any additional evidence as requested. However we support your request for further quantifiable evidence of the perceived benefits from customers and suppliers.

### Further considerations

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<sup>1</sup> CMP224 Final Modification Report: <http://www2.nationalgrid.com/WorkArea/DownloadAsset.aspx?id=33237>

- *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?*

Changes due to a charging methodology change may have a different effect on customers than changes during the charging setting process. This is because such changes can be less transparent to customers and therefore less predictable.

When significant changes are made to the way charges are calculated, charge payers need sufficient time to be able to account for these changes in their pricing structures. On this basis a fifteen month notice period for changes to charges due to developments in the operation of the network may be appropriate if these changes are significant. However care needs to be taken to ensure that the charging methodologies remain sufficiently flexible to allow more modest changes and those of an urgent nature to be made in appropriate timescales.

- *Do the benefits of certainty outweigh any costs or effects of delay?*

The assessment of the benefits of certainty against the costs or effects of delay should be made on a case by case basis for each change proposal. In some cases it may be appropriate to make short notice changes to the distribution charging methodologies, and care should be taken to ensure that DCP178 does not have any unintended consequences in this area.

- *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?*

We are aware that the EDCM charging methodology is currently subject of a review. It is our understanding that this methodology is currently perceived by some to be volatile and unpredictable. It would appear counterproductive that any proposals arising from this review to improve the stability and predictability of DUoS charges could be delayed by DCP178.

We understand that electricity distribution networks are becoming increasingly active and DNOs are increasingly moving towards becoming Distribution System Operators (DSOs). In addition to broader potential framework changes that may be required to facilitate this role, this may result in a greater interaction between electricity distribution and transmission charging methodologies. For example, we are currently engaging with stakeholders in the development of potential transmission charging arrangements for exporting GSPs. We understand that some of the options currently being considered may have consequential requirements for DNO licence and charging methodology changes. Hence this may be an area of potential benefit delayed by the approval of DCP178.