Scottish and Southern Energy Power Distribution

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Dear Andy,

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

Scottish and Southern Energy Power Distribution welcome the opportunity to respond to Ofgem's recent consultation on the benefits and risks of DCP 178. We have been involved in the industry working group on this matter and have responded to the working group consultations that have been issued to date. Our views expressed throughout the modification process to date remain valid in respect of this further consultation.

We note that Ofgem's consultation states that most suppliers and DNOs who voted at the industry voting stage supported the modification proposal. However, a number of DNOs, including us, rejected the proposal, considering that on balance it would introduce an inappropriate level of risk on DNOs which could ultimately result in higher networks' financing costs. This, in our view, would not be in the best interests of customers. Further detail on our reasoning is provided below.

We recognise the importance of mitigating the volatility and enhancing the predictability of network charges in allowing suppliers to efficiently manage their risk when setting tariffs and agreeing contracts with customers. Our views are driven by the need to balance the costs associated with deferring networks' allowed revenues and the costs arising from suppliers setting tariffs at different times to the networks annual charge setting cycle.

For this reason, we were fully supportive of the policy changes that Ofgem consulted on and implemented to address this issue two years ago. These changes were considerable and included the introduction of a two year lag on penalties and rewards seen under incentives; a two year lag on some uncertainty mechanisms; and limiting network charge changes to once per year. We also note that Ofgem fixed base revenues for DNOs for the commencement of the new price control period in 2015/16 at an early stage to ensure that suppliers were given sufficient notice. This decision resulted in the appropriate balance of risk between DNOs and suppliers. One option considered at that time was the 15 month notice period that is the subject of DCP178. In our view, the reasons for Ofgem's rejection of the proposal to provide 15 months notice of final tariffs have not changed. We consider that the recent policy changes, once fully implemented, will be effective and will ensure the continuing appropriate balance of risk.

Approval of DCP178, which would require DNOs to issue final tariffs 15 months prior to implementation, would seriously undermine the recent policy changes already implemented. For example, the two year lag was introduced to ensure that adjustments to allowed revenue as a result of penalties and rewards given under incentives were able to be accurately accounted for in network charges. Fifteen months prior to final tariff implementation, we will not yet know our final position on the incentives for the relevant year and hence we will be in a position of providing forecast rather than actual penalties and rewards under the incentives, rendering the two year lag ineffectual. Approval of this proposal would result in the reopening of these recent policy changes before there has been opportunity to assess their impact on the predictability and volatility of charges.

Notwithstanding the potential to unravel recent policy changes, implementation of DCP 178 would introduce significant cash flow risk which would need to be taken into account when considering appropriate financing. Forecasting all of the CDCM and EDCM model inputs 15 months ahead would introduce a real possibility of inaccuracy in tariffs and we are not convinced that this would ultimately be in the best interest of customers. In particular, EDCM customers may be exposed to significant risk of DUoS charges that are not wholly cost reflective, due to the reliance on 15 month forecasts. Further, this would increase our risk of over or under-recovery and hence the likelihood that we would be penalised under CRC 2A.

Finally, it is important to note that whilst implementation of DCP 178 could improve predictability, this would almost certainly come at the cost of volatility, which we understand to be a very real concern for our customers.

In summary, we are opposed to DCP 178 which, as proposed, would be inconsistent with recent regulatory policy decisions and, if implemented, would require substantial revision to agreed regulatory funding mechanisms including the two year lag and ‘k factor’ forecasting thresholds. More importantly, we would contend that no evidence has been presented to demonstrate that suppliers’ actions arising from DCP 178 would result in tangible benefits being passed on to consumers.

If you have any questions on our view or would like to discuss this further then please do not hesitate to contact me.

Yours sincerely,

Gwen MacIntyre
Regulation, Networks