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Beth Hannah  
The Office of Gas and Electricity Markets  
9 Millbank  
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Our Ref: NT/PW/DCP178

19 September 2014

Dear Miss Hannah

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

Northern Powergrid is the UK parent company of Northern Powergrid (Northeast) Limited and Northern Powergrid (Yorkshire) plc. As the proposer of the above Distribution Connection and Use of System Agreement (DCUSA) change proposal we welcome the opportunity to respond to this consultation. This letter provides a summary of our position as well as our responses to your specific questions which can be found in appendix 1.

Northern Powergrid raised DCUSA Change Proposal (DCP) 178 following feedback from our stakeholder engagement events, including a sequence of bi-lateral meetings that we had held with those energy suppliers who responded to our invitations. It was clear that suppliers wanted to see more certainty/predictability in the path of future Distribution Use of System (DUoS) charges. They indicated that they typically offer 18 month to three year contracts (normally in October and [to some extent] April) and that they need to price some risk premium into the products that they offer to end-users to cover areas of uncertainty, including DUoS charges.

DCP178 proposes to provide 15 months' notice rather than the current 40 day period. The main benefits of the proposal are:

- Suppliers will have between 15 and 27 months certainty of what DUoS charges will be, rather than the current 3 to 15 months. This change should:
  - Create the potential for the introduction new products (e.g. non-pass through of DUoS contracts for extra-high voltage (EHV) consumers);
  - Reduce the risk premium in existing DUoS non-pass through products; and
  - Enhance the ability of Suppliers to forecast and budget for DUoS charges.
- End-users - will potentially face lower charges from suppliers, as the supplier would not have to include such high risk premiums into their products as there will be more certainty on the DUoS element of their charge. Those end users who have pass-through contracts with their supplier will also benefit as they will know their tariffs for the

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same timescales which will greatly assist in their business planning and provide economic benefit through cost certainty.

We also recognise that this proposal is not without risk, the main ones being:

- The timeline for future DCUSA changes may need to be extended;
- There is the potential for less price stability with larger year-on-year movements in prices in order to correct for prior years over/under-recoveries; and
- The appropriateness of the over/under-recovery price control parameters need to be considered given the greater risk of significant levels of over/under-recovery.

Ofgem will need to evaluate the impact of this change proposal against the proposed new RII0-ED1 licence drafting for slow track companies and against the work on charging volatility that has already been proposed to decide if now is the right time to consider introducing this change.

If you have any queries or concerns regarding the above, or if you would like to arrange a meeting to discuss the content of our response, please do not hesitate to contact me.

Yours sincerely

*Pat Wormald*

Charges Manager

## Appendix 1 - Responses to specific consultation questions

Question	Response
Do you agree with the working group's view that DCP178 would result in these benefits and costs?	<p>We agree with the working group that these are the potential benefits from the introduction of increased notice periods, but note that they are only worth pursuing if they result in quantifiable reductions in the end-user tariffs that suppliers offer.</p> <p>In terms of the costs and other effects we agree that the change has the potential to increase the implementation date for future modifications, compared to the current arrangements, but all parties would be aware of the timeline for future changes.</p> <p>The risk of excessive levels of over/under-recoveries has always been a concern with this change proposal, especially given that two of the biggest influencing factors, the environment (weather) and the economic climate, are outside the control of the DNOs. This additional risk needs to be balanced against: the potential for lower end-user charges; the proposed new RIIO-ED1 licence drafting for slow track companies; and Ofgem's willingness to waive the penalty charges where excessive levels of under/over-recovery are material due to the factors described above.</p> <p>Under the latest RIIO-ED1 licence, which was not available when this change proposal was developed, paragraph 2A.2 states that "The licensee, in setting Use of System Charges, must use its best endeavours to ensure that, in Regulatory Year t, Regulated Distribution Network Revenue is equal to its Allowed Distribution Network Revenue.", this gives a clear intent that the regulator wishes to minimise under/over-recoveries which is counter to this proposal.</p>
Are there any other benefits and costs that you think would result from DCP178?	None that we are aware of at this stage.
For suppliers and customers, can you provide supporting evidence for the benefits identified by respondents to the working group's consultations?	N/A - question for suppliers
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?	<p>Whilst we believe open governance to be a good thing, we can also see the drawbacks arising when lots of small changes are submitted. This can lead to a significant amount of dedicated resources being required to develop and assess change proposals.</p> <p>In recent years there have been a significant number of changes progressed through working groups, many of which have taken in excess of one year to come to a conclusion. Even straight forward changes can take time to progress and there is no mechanism in place to have a cut-off date for changes to be approved, which can cause issues when decisions are made late in the day and have to be factored into the charge setting calculations for the following year.</p> <p>We believe a proposal such as DCP164, which was rejected by Ofgem, would have helped the process. However, if DCP178 is approved it may help to focus the timeliness of the development of future changes.</p> <p>That said, we recognise that it has been an important aim of Ofgem to reduce volatility in network charging and Ofgem has -</p>

Question	Response
	<p>already made decisions<sup>1</sup> which will improve the situation. This change increases the predictability of charges it does not necessarily reduce the volatility in charges. Indeed, it may increase volatility.</p> <p>The change does complement Ofgem's decision to no longer allow intra-year changes but interestingly that decision noted that there was not a strong desire for the three month notice period to be changed. Where this change is possibly at odds with the prior decisions is on the introduction of additional lag to the adjustment of over- or under-recoveries and pass-through costs as the final values will not be known at the time of setting prices. This will also be the case for adjustments relating to the annual iteration process.</p>
Do the benefits of certainty outweigh any costs or effects of delay?	<p>This is difficult to answer as a DNO. There are currently a number of changes progressing through the DCUSA process and each one is assessed in isolation so the overall impact of numerous changes is never actually seen. With respect to this specific change proposal it will all depend on the outcome of the suppliers cost benefit analysis and the magnitude of the potential reductions in the end users energy charges. The bigger the reduction the more likely it is that the benefits will outweigh the downside of the delay.</p>
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?	<p>The main example that springs to mind is the current review of the EDCM model. Careful consideration will need to be given to the timing of bring forward any future changes and the impact on the possible implementation dates.</p>

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<sup>1</sup> [Decision in relation to measures to mitigate network charging volatility arising from the price control settlement](#)