



Making a positive difference
for energy consumers

Independent Distribution Network
Operators and other interested
parties

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Date: 29 March 2019

Supplier of Last Resort – derogation to Independent Distribution Network Operators in respect of Octopus Energy Limited’s Last Resort Supply Payment claim

This letter covers a direction on all electricity Independent Distribution Network Operators (IDNOs) with a Use of System charging methodology approved by the Authority.¹

Background

We published our decision on 6 February 2019 to grant a request from all Distribution Network Operators (DNOs) for a derogation from their charging methodology and the notice period required due to a Last Resort Supply Payment (LRSP) claim by Octopus Energy Limited.² DNOs have subsequently published amended Use of System charges effective from 1 April 2019.

Standard licence condition (SLC) 13.1 of the electricity distribution licence states the licensee must have in force at all times, and comply with, a Use of System charging methodology approved by the Authority. Amended Standard Condition BA2.3 of each IDNO’s licence also requires them to set Use of System Charges in relation to Domestic Customers that do not exceed the Use of System Charges to equivalent Domestic Customers in a given DNO region.

In order to comply with their licence requirements, IDNOs, who have had a charging methodology approved by Authority, have set out that their charging methodology is to replicate the Use of System charges for Domestic Customers of the relevant DNO.

Reasons for a derogation

The approach taken by DNOs to recover the LRSP amount will result in an increase in charges for residential customers connected to DNO networks, but not for those customers on IDNO networks or for non-residential customers. We stated in our decision of 6 February 2019 that we do not expect IDNOs to increase charges to their customers, as they have not incurred any additional costs. Furthermore, the mechanism for recovering an LRSP claim and returning it to the claimant (under SLC 38), does not apply to IDNOs.

¹ References to the “Authority”, “Ofgem”, “we” and “our” are used interchangeably in this document. The Authority refers to GEMA, the Gas and Electricity Markets Authority. The Office of Gas and Electricity Markets (Ofgem) supports GEMA in its day to day work.

² <https://www.ofgem.gov.uk/publications-and-updates/decision-grant-all-dnos-derogations-charging-years-201920-and-202021-due-last-resort-supply-payment-claim>

This creates a conflict with the IDNOs' approved Use of System charging methodology, as the effect is to replicate the charges of the DNO in whose region they are operating. We therefore consider that a derogation is needed from SLC 13.1 so that IDNOs are not required to comply with their charging methodology insofar as it is necessary to avoid the effects described above. For clarity, we thus expect each IDNO's Use of System charges to be no higher than the relevant DNO, less any amount attributable to recovery of any LRSP costs.

Our decision and next steps

We have considered this issue in accordance with our principal objective and statutory duties and decided that a derogation from SLC 13.1 of the electricity distribution licence is necessary in this case.

Concerning the overall Supplier of Last Resort (SoLR) process, our view remains that all consumers benefit from these protections and that, in principle, the cost should be spread across all consumers. This has not been possible in this case due to the circumstances and timings associated with the claim, and the current licence drafting. We have worked with DNOs, IDNOs and other interested stakeholders over the last year to review the process for recovering the costs associated with an LRSP claim. We have recently consulted on changes to the electricity distribution licence to facilitate this.³ We consider that, if implemented, these changes will avoid the need for derogations in the majority of future SoLR events.

If you have any questions regarding this letter, please contact David McCrone (david.mccrone@ofgem.gov.uk) in the first instance.

Direction

The formal direction to IDNOs is found in an annex to this letter.

Yours sincerely

Andrew Self

**Head of TCR, Energy Systems Transition
For and on behalf of the Authority**

³ <https://www.ofgem.gov.uk/publications-and-updates/statutory-consultation-modification-electricity-distribution-licence-recover-costs-associated-appointing-supplier-last-resort>

Direction made by the Gas and Electricity Markets Authority

To:

1. ESP Electricity Ltd;
2. Independent Power Networks Ltd;
3. The Electricity Network Company Ltd;
4. Energy Assets Power Networks Ltd;
5. Eclipse Power Networks Ltd;
6. Harlaxton Energy Networks Ltd;
7. Leep Electricity Networks Ltd;
8. UK Power Distribution Ltd;
9. Fulcrum Electricity Assets Ltd;
10. Energetics Electricity Ltd.
11. Murphy Power Distribution Ltd
12. Utility Assets Ltd

WHEREAS:

- A. Each of the companies to whom this Direction is addressed (each an "IDNO") holds a licence granted, or treated as granted, pursuant to section 6(1)(c) of the Electricity Act 1989 (the "Distribution Licence") and has a charging methodology approved under Standard Licence Conditions ("SLC") 13.1 of such licence as described further below.
- B. GEMA issued a Direction ("LRSP Direction")⁴ to all Distribution Services Providers⁵ on 6 February 2019, in response to a valid claim for a Last Resort Supply Payment by Octopus Energy Limited. The LRSP Direction was not addressed to IDNOs. As a result, Use of System charges for domestic customers on each Distribution Services Provider's network will increase.
- C. SLC 13.1 of the Distribution Licence requires all holders of a Distribution Licence to comply with the Charging Methodology as set out in SLC 13 and as approved by GEMA. SLC 13.1 gives GEMA the power to grant a derogation from the obligation to comply with the Charging Methodology.
- D. Amended Standard Condition BA2.3 of each IDNO's Distribution Licence requires IDNOs to set Use of System Charges in relation to Domestic Customers that do not exceed the Use of System Charges to equivalent Domestic Customers in the Distribution Services Area.⁶
- E. In order to ensure compliance with the requirement described in recital D above, the approved Charging Methodology of each of the IDNOs replicates the equivalent use of system charges of the Distribution Services Provider of each Distribution Services Area.
- F. The effect of complying with a Charging Methodology on the terms described in recital E, where each Distribution Service Provider has increased charges (as described in recital B) would be to increase charges to users of the IDNO's network where there has been no corresponding change to the costs borne by the IDNO.
- G. GEMA therefore considers it appropriate to make the Direction set out below, for the reasons set out in the accompanying letter dated 29 March 2019, which constitutes

⁴ https://www.ofgem.gov.uk/system/files/docs/2018/02/coop_solr_derogation_letter_0.pdf

⁵ As defined in Condition 1 of the Distribution Licence.

⁶ As defined in Condition 1 of the Distribution Licence.

GEMA's notice of reasons pursuant to the Electricity Act 1989.

NOW THEREFORE:-

1. GEMA hereby directs pursuant to SLC 13.1 that each IDNO:

is not required to comply with its Charging Methodology approved pursuant to SLC 13, only insofar as it is necessary to avoid the effect described in recital F.

2. The direction shall have effect from the date stated below.

Dated: 29 March 2019

Andrew Self

**Head of TCR, Energy Systems Transition
For and on behalf of the Authority**