

Decision

Licence fee cost recovery principles

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We have reviewed the responses and considered stakeholder views about on minor changes to the licence fee cost recovery principles. We will adopt the proposed changes to the principles and will retain the accompanying letter.

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1. Introduction

Background

1.1. We consulted on proposed changes to the licence fee cost recovery principles (the “principles”), which set out how the amounts payable to Ofgem under the gas and electricity transmission and distribution licences are calculated and billed.

1.2. A change is required to the billing schedule in accordance with HM Treasury rules and for consistency with other regulators, but will not impact the licence fee cost.

1.3. The consultation set out proposed amendments to the principles, including in relation to the returning of surpluses to licence fee payers and asked for comments on the accompanying letter.

Our decision making process

1.4. We consulted from 8 March to 4 April 2021 and received ten responses. We asked interested parties to provide answers to two questions and considered all views and evidence presented to us. We also involved licencees in a discussion concerning licence drafting changes and are continuing to have a dialogue with them about further drafting suggestions.

Our decision

1.5. We have considered the responses received to the consultation and also the views of HM Treasury and practices of other regulators. We have concluded that:

- All of the proposed changes to the principles will be adopted and apply to the financial year 2021-22 calculations and bills;
- The accompanying letter will be retained. The letter for Tranche 2 will continue to include the costs and allocation, but will exclude the narrative explanation (except where there is a material change from Tranche 1);

- To improve transparency, the letter will list the non-confidential fees payable by all parties who have their customer numbers published elsewhere. Independents will continue to get an individual letter so that customer numbers are not published; and
- Licence changes need to be considered and will continue to be discussed with licensees. A separate statutory consultation will be run in relation to any changes.

Your feedback

General feedback

1.6. We believe that consultation is at the heart of good policy development. We are keen to receive your comments about this report. Please send any general feedback comments to financialaccounts@ofgem.gov.uk

2. Proposed updates to the principles document

Question 1:

Do you have any comments on our proposed updated principles? The main proposed change is the way in which any surplus at the end of the year is managed.

2.1. Responses covered the following areas:

- Retaining existing approach to calculation and billing
- Timing and approach for credit notes and invoices
- Impact on licence conditions
- Changes in costs
- Customer definition

Retaining existing approach to calculation and billing

2.2. Several responses expressed a preference to retain the approach to calculation and billing in the 2016 principles. Others accepted the proposal and were supportive of the intention to align with HM Treasury rules and the practices of other regulators.

2.3. We have considered the views of stakeholders and reviewed the responses, and have concluded that no evidence would cause us to change our proposal given that the proposal is in accordance with HM Treasury Rules and is consistent with the approach taken by other regulators.

2.4. We note the concerns raised on managing the impact of the change, which are addressed in the next sections of this document.

Timing and approach for credit notes and invoices

2.5. Six responses asked for more information about the timing and process around the billing and credit notes.

2.6. Credit notes for any prior year surplus will be issued alongside the Tranche 1 invoice for the following year. For example, 2020-21 credit notes will be sent out with 2021-22 tranche 1 invoices. This will allow licencees to offset the credit note against the new invoice if they choose. This is expected to be in July of each year although if we have received all of the customer number information by mid-May, we will try to do this in June. We will continue to ask for payment of licence fee invoices within 30 days from the invoice date. Additional text will be added into the principles document to make this timing and approach clearer (reflecting some of the information set out here).

2.7. If licencees do not wish to offset or are not able to do this, then we request that bank details be provided to Ofgem (on company letterhead sent to invoices@ofgem.gov.uk) to allow Ofgem to settle the credit note. If you would prefer this option, please provide the details to us during June to facilitate prompt payment.

2.8. Tranche 2 invoices will be issued as normal.

2.9. Licencees paying the minimum £500 fee will continue to be billed for the full £500 in tranche 1 and nil in tranche 2. These parties will be excluded from the process to return funds unspent from the prior year so as not to burden them, and therefore consumers with additional transaction costs.

2.10. One response also asked about forecasts for future licence fee costs. Ofgem's forward work plan sets out Ofgem's future budget plans which may be helpful to licencees for forecasting purposes to show where we expect there to be an increase or reduction in future. Where we expect significant changes in future years we will try to include this in the accompanying letter, however because of the nature of government spending we do not always have approved budget for anything beyond the current year.

2.11. We are aware that licencees may need to raise a purchase order for the licence fee and that it is necessary to have advanced notice of the payment amount. Please contact invoices@ofgem.gov.uk in May to request the amount. We cannot calculate the amounts until we receive all customer numbers from all licencees so we will provide an estimate of the invoice amount as soon as we can. Licencees should then send us the PO numbers in June to allow us to raise the invoice on a timely basis.

Impact on licence conditions

2.12. Condition 3.3 of the Gas Transporters Licence Standard Conditions requires payment of the first instalment by 30 June each year. We think the current wording allows suitable cover for the revised timetable and we will note in the principles document that invoice timing would be June or July but would always give 30 days to pay.

2.13. We will continue to engage with licencees to consider whether licence modifications are advisable in relation to:

- standard condition 3.2(m) of the Gas Transporter Licence, which includes both gas transmission and gas distribution, standard condition 5.1 of the Electricity Distribution Licence, and standard condition A4.3 of the Electricity Transmission Licence, which includes National Grid ESO;
- special condition 6.1 in the Gas Transmission, Gas Distribution and Electricity Transmission licences and special condition 3.2 of the National Grid Electricity System Operator Limited;
- special condition CRC 2B of the Electricity Distribution Licences; and
- any other aspects of the licences which may no longer align.

2.14. As appropriate, we will then run a statutory consultation to consider any such modifications.

2.15. Alongside considering the licence conditions, we will look at amending the RIGs to reflect the updated principles.

Changes in costs

2.16. One response noted that if an increase in Ofgem (or metrology or advocacy) budget is approved and the activity is funded through licence fees, Ofgem will inform licensees that this amount will be recovered, but that it is not clear whether budgetary changes will be published for other stakeholders' information. Any changes to budgets will be published as part of the HM Government supplementary estimates process¹.

2.17. One response noted that the cost categories in para 2.4 of the licence fee cost recovery principles may not align to the licence conditions where the costs are listed in the

¹ <https://www.gov.uk/government/collections/hmt-supplementary-estimates>

licence itself. We will consider this alongside the consideration of whether any licence conditions need to be modified.

2.18. One response noted that for the TNUoS tariffs, it may be beneficial to consider changes to the wording of SLC A4 4(b), to refer to the second instalment being net of any credit notes issued, or through the definition of LfT in SpC 3.2 Part A 3.2.3 being worded as being 'net' payments made by the licensee. We will consider this alongside the consideration of whether any licence conditions need to be modified.

Customer definition

2.19. One response proposed that the definition of an electricity customer is aligned with that used by the DNOs to report performance under the Interruptions Incentive Scheme (IIS). We have considered the proposal but cannot see a clear benefit in making such a change, so do not propose to do so at this time.

Other changes to the principles

2.20. There were no concerns raised with the other proposed changes to the principles document, which will be adopted in full. In addition, some of the detail on timing and process set out in this decision will be incorporated into the principles document.

3. Letters accompanying invoices

Question 2:

Do you have any comments on the form and content of the letters, which accompany invoices?

3.1. Responses could be summarised as follows:

- Six responses to keep the letter in the current format
- Two responses to keep the level of detail in the tranche 1 letter but that tranche 2 letter could be simplified to avoid duplication
- One response to simplify the letter as long as key sections were retained
- One response with no comments on the letter

3.2. We agree to continue to provide the accompanying letter as responses show they provide useful information for licencees for audit and transparency. Where there has been no significant change to figures between tranche 1 and tranche 2, this will be stated in the tranche 2 letter and the narrative description from tranche 1 will not be repeated.

3.3. To provide further transparency and to streamline the process, one letter will be prepared for all DNOs, GTs and GNDs. This letter will include the non-confidential licence fee amounts payable by all.

3.4. For independent transmission companies, an individual letter will continue to be prepared as there was concern raised about the commercial sensitivity of the customer numbers. If there is no commercial sensitivity in future, we will move to one letter for all.

3.5. Where the minimum fee of £500 is payable, one letter will be prepared for all parties. The letter will exclude customer numbers and the names of the companies. As above, if there is no commercial sensitivity in future, we will move to one letter for all.

4. Conclusion and next steps

4.1. The updated principles will be published in June/July 2021. 2021-22 invoices and letters will follow the new approach, and will be issued in June/July 2021 along with a credit note for any 2020-21 unspent funds.

4.2. We will continue to engage with licencees to consider whether licence modifications are advisable. As appropriate, we will then run a statutory consultation to consider any such modifications.