



Making a positive difference
for energy consumers

Company Secretary
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Date: 17 February 2017

Dear Company Secretary,

Derogations pursuant to Standard Licence Conditions (SLC) 13A Part E, 13B Part E and 14.12 of the Electricity Distribution Licence and Clause 19.1B of the Distribution Connections and Use of Systems Agreement (DCUSA)

Background and summary

Distribution Network Operators (DNOs) recover their allowed revenue from customers through distribution use of system (DUoS) charges. The methodologies for calculating these charges are the Extra High Voltage Distribution Charging Methodology (EDCM) for the large, industrial customers connected at the highest voltages, and the Common Distribution Charging Methodology (CDCM) for the remaining customers. The CDCM and EDCM are detailed in the DCUSA document.

In a letter dated 16 February 2017, you set out the background to an error in the application of the charging methodologies for Western Power Distribution (WPD) (South Wales) Plc and WPD (South West) Plc for 2017/18, and proposed an approach to correcting the error. Your letter consolidated earlier correspondence with us as you sought the most appropriate way to correct the error.¹ You proposed that for some EDCM customers you would issue an addendum to correct tariffs for 2017/18 and for the remaining affected customers, you would manually correct the tariffs for 2019/20.

Owing to the consequences of the error, you have requested four derogations for each licence area:

- To allow you to issue an addendum to prices for some EDCM customers for 2017/18 you are requesting two derogations:
 - A derogation under SLC 14.12 to amend prices at less than three months' notice.
 - A derogation under Clause 19.1B of the DCUSA, which enables the Authority to direct that the periods of notice described in Clause 19.1A shall not apply, and that the notice period shall instead be 40 days (without prejudice to any longer notice requirements prescribed by the Distribution Licence).
- To allow you to charge EDCM customers incorrectly for 2017/18 and to correct this error for some of them in 2019/20:

¹ You first highlighted the issue to us on 1 December 2016, proposing to republish all prices for 2017/18.

- A derogation under SLC13B Part E, to price outside of the EDCM specifically in terms of the Network Use Factors calculation for 2017/18 and 2019/20 site specific prices.
- To allow you to charge CDCM customers incorrectly for 2017/18 and to correct this error in 2019/20:
 - A derogation under SLC13A Part E, to price outside of the CDCM for 2017/18 and 2019/20.

This letter gives consent for your requested derogations.

The error

You made an error in a formula in the Network Use Factor calculation for the South West and South Wales areas so the EDCM charges were incorrect for 2017/18. For some customers the charges were higher than the correct level, for others the charges were lower. Overall, the charges for EDCM customers were lower than they should have been. As the overall CDCM charges are based on the outstanding revenue not recovered from EDCM customers, the charges for CDCM customers for 2017/18 were higher than they should have been.

Impact of the error

You have identified that the overcharge for CDCM customers in the two licence areas will be less than 1% of the total DUoS charge. For most EDCM customers the impact (over or undercharge) will be less than 1% or less than £1,000 of the DUoS charge.

However, for a minority of customers the error results in incorrect charges of over 1% and over £1,000 of the DUoS charge. There are 71 customers in this category: in South Wales, 36 sites would be undercharged and 4 overcharged; in South West, 19 sites would be undercharged and 12 overcharged.

WPD's proposed approach to correcting the error

Following engagement with us on this issue you have proposed an approach that seeks to mitigate customer detriment.

For those 16 customers that are facing the highest overcharge (over 1% and over £1,000 of the DUoS bill) in 2017/18, you have sought consent to issue an addendum to the site-specific prices to correct the error, removing the overcharge. You have said that the nature of the supply contracts for these large customers means that the reduction in charges should be passed directly onto the customers.

For the remaining customers (all CDCM customers and all EDCM customers but the 16 referred to above) you propose to correct the error in the tariffs for 2019/20. You are proposing this to maintain the 15-month notice period for setting charges. The error to be corrected will be multiplied by two years of forecast inflation to adjust for the time value of money. For EDCM customers, individual customer charges will be corrected directly for the error from 2017/18; the error for CDCM customers will be corrected so that the overcharge for 2017/18 is returned to this group of customers collectively.

In recognition of the uncertainty caused by the error, you have agreed to make a goodwill payment of £300,000 funded by your shareholders. This payment will be split evenly between the Centre for Sustainable Energy and the Energy Savings Trust to fund projects in each of the affected licence areas. You have committed to require the charities to use the goodwill payment to finance projects that support domestic vulnerable and/or fuel poor consumers in these areas. Projects may include referral pathways to support energy

consumers in vulnerable circumstances and projects that deliver innovative products or services with realistic prospects of delivering direct benefits to consumers. You have committed to report to us on how this funding is used by each of the charities.

You have also stated you are working with your internal auditors to put in place additional controls and assurance around the data provided to your pricing team, particularly when there are changes to the underlying codes and equations which form the methodology. This is in an effort to prevent such errors from happening in future.

Decision

We have considered your request in accordance with our principal objective and statutory duties. We have decided to grant the requested derogations.

In applying for the derogations to correct the error you have sought to address all of the customer detriment, dealing separately with CDCM and EDCM customers:

- For those 16 EDCM customers that would have been overcharged the most by the error in 2017/18, the addendum to those prices will mean that they won't be overcharged.
- For the remaining EDCM customers facing incorrect charges 2017/18, you have sought to maintain the 15-month notice period for changes to charges by not reversing the error until 2019/20 (including corrections for the time value of money). You have committed to give these customers at least 24 months' notice of the impact on their charges as a result of this error. While this will introduce some additional volatility to the charges, we note that this is within historical levels of volatility that EDCM charges are subject to.
- All affected CDCM customers will be facing an overcharge of less than 1% of the DUoS bill in 2017/18. This group of customers will be compensated (including for the time value of money) in 2019/20 to maintain the 15-month notice period for setting charges. We consider that any attempt to administer direct compensation to individual customers would be disproportionate given the error amounts to less than 1% of the DUoS charge (equivalent to less than £1 for domestic customers).

We also acknowledge the fact that you informed us of the error as soon as you discovered it and that you have sought to correct the error in the fairest way, minimising customer detriment. Furthermore, you have begun to undertake steps to prevent such an error from occurring in the future.

Nonetheless, the error would have resulted in a breach of your licence had you not identified it and taken steps to resolve it. The error has caused additional volatility to charges and will result in the intended 15-month notice period for charges being reduced to 40 days for some customers.² We are concerned that the additional certainty that the extended notice period was meant to bring has been undermined by errors for the first year it has applied (2017/18). We consider that your goodwill payment of £300,000 to charities assisting fuel poor consumers in the affected areas is an appropriate gesture in light of the scale of the error.

² Albeit these customers will see a reduction in charges relative to the 15-month notice position.

Direction

The Authority hereby directs:

- Pursuant to paragraph 13B.14 of SLC13B Part E, that WPD (South Wales) plc and WPD (South West) plc may price outside of the EDCM for 2017/18 and 2019/20, specifically to recognise the error in 2017/18 that was a consequence of the incorrect calculation of Network Use Factors to the EDCM, and to reverse this error in 2019/20, taking account of the time value of money.
- Pursuant to paragraph 13A.14 of SLC13A Part E, that WPD (South Wales) plc and WPD (South West) plc may price outside of the CDCM for 2017/18 and 2019/20, specifically to recognise the error in 2017/18 that was a consequence of the incorrect calculation of Network Use Factors to the EDCM, and to reverse this error in 2019/20, taking account of the time value of money.
- Pursuant to paragraph 14.12 of SLC14 Part F, that WPD (South Wales) plc and WPD (South West) plc may amend prices at less than three months' notice for 2017/18 for the 16 EDCM customers that would otherwise be overcharged more than 1% and more than £1,000.
- Pursuant to Clause 19.1B of the DCUSA, that the periods of notice described in Clause 19.1A shall not apply to WPD (South Wales) plc and WPD (South West) plc for 2017/18 and that the notice period shall instead be 40 days for the 16 EDCM customers that would otherwise be overcharged more than 1% and more than £1,000.

This constitutes the reasons for our decision under section 49A of the Electricity Act 1989.

If you have any questions concerning this letter please contact my colleague Tim Aldridge (tim.aldrige@ofgem.gov.uk / 020 7901 7350).

Yours faithfully,

**Andrew Self
Head of Electricity Network Charging
For and on behalf of the Authority**