

Email Andrew.Wright@ofgem.gov.uk

Andrew Wright  
Senior Partner  
Energy  
Systems Ofgem  
9 Millbank  
LONDON SW1P 3GE

Avonbank  
Feeder Road  
Bristol  
BS2 0TB

Telephone 0117 9332175  
Email [asleightholm@westernpower.co.uk](mailto:asleightholm@westernpower.co.uk)

Our ref

Your ref

Date

16 February 2017

Dear Andrew,

### **Derogation Request – 2017/18 Charges for Use of System**

Thank you for the opportunity to meet on 19<sup>th</sup> January 2017 to discuss our proposal for the correction of charges in the South Wales and South West resulting from the issue identified in relation to the 2017/18 charging year.

We are writing to you to request the application of Option 6B as our proposed solution.

In summary, we seek to correct prices for all customers affected, to provide at least 15 months' notice of the new prices, and also to correct prices in 2017/18 for EDCM customers who would otherwise be materially overcharged in 2017/18. Furthermore, in recognition of the error made we propose to make a goodwill payment to benefit fuel poor customers.

#### **The Issue**

The issue itself was in a formula in the Network Use Factor (NUF) calculation for the South West and South Wales areas. The formula was amended for DCP138.

(Abs [Max contingency flow]) was incorrectly set to equal ([Total MW usage]) \* SF; where Total MW usage, is the sum of the absolute values of the "MW usage" of all demand users of that asset (expressed in MW).

Max contingency flow is the maximum post-contingent flow through the asset in MVA. The maximum post-contingency asset flows may be extracted from the 'locational' analyses. SF is the security factor.

Using Total MW usage has the effect of treating the South West and South Wales customers with a power factor of 1. However not all the large EDCM customers have a power factor close to 1. The correction of this has caused the NUFs to change, which in turn has led to changes in the final EDCM charges. This issue has been corrected for 2018/19 tariffs which were set in December 2016.

### **Impact**

Our impact analysis has quantified the impact of this issue on 2017/18 prices for WPD South Wales and WPD South West customers. These customers are charged using the Long Run Incremental Cost (LRIC) methodology.

The impact for CDCM mass market customers and most EDCM industrial customers will be less than 1% of the DUoS bill as shown in the following tables.

<b>South Wales CDCM 2017/18 = 88 pence for average dom. customer</b>				
Tariff	Published Average Charge (£/customer)	Re- Published	Difference in average charge (£/customer)	Difference in Average charge
		Average Charge (£/customer)		(% )
Domestic Unrestricted	106.52	105.64	0.88	0.83%
Domestic Two Rate	121.12	120.12	1	0.83%
Small non Dom Unrest	351.13	347.97	3.16	0.91%
Small Non Dom 2 rate	500.82	496.28	4.54	0.92%
LV HH Metered	7,110.83	7,053.22	57.6	0.82%
LV HH Metered	54,871.38	54,352.98	518.39	0.95%

<b>South West CDCM 2017/18 = 3 pence for average dom. customer</b>				
Tariff	Published Average Charge (£/customer)	Re- Published	Difference in average charge (£/customer)	Difference in Average charge
		Average Charge (£/customer)		(% )
Domestic Unrestricted	120.95	120.91	0.03	0.03%
Domestic Two Rate	130.55	130.52	0.03	0.02%
Small non Dom Unrest	291.46	291.36	0.11	0.04%
Small Non Dom 2 rate	423.56	423.43	0.13	0.03%
LV HH Metered	4,840.53	4,839.38	1.15	0.02%
LV HH Metered	38,908.46	38,898.19	10.28	0.03%

Note: The Differences were created before rounding.

There is a small subset of large industrial customers who will be affected by more than 1% of their bill as shown in the following table.

DNO Area	Total EDCM sites	Number undercharged >1% (and over £1,000)	Amount undercharged	Number overcharged >1% (and over £1,000)	Amount overcharged
South Wales	187	36	1%-156% £1k-£417k Total £1,960k	4	1%-16% £5k-£21k Total £62k
South West	292	19	1%-30% £1k-£60k Total £224k	12	1%-13% £1-£50k Total £151k

### **Context of this error**

Whilst we appreciate that an error has been made we would like to put this error into context with other impacts on tariffs.

As explained in the earlier derogation request (December 2016), in December 2015, at the time of setting the forecast allowed revenue for 2017/18, the allowed revenue for the South West was £330m and for South Wales it was £236m. As at December 2016, the latest forecast allowed revenue for 2017/18 is £335m for the South West and £242m for South Wales.

This means that as a result of the introduction of the 15 month notice period WPD have priced on a reduced allowed revenue for 2017/18 in South West by approximately £5m (1.8%) and in South Wales by approximately £6m (3%). This is likely to fully offset the impact of the error on CDCM customers.

To put the amounts into perspective we have also included some examples of previous anomalies in prices which were outside the DNO's control.

During the year of 2013/14 the DNOs were notified for the first time by National Grid of large historical reconciliations. For our West Midlands network these amounted to approximately -£7m, which was -1.8% of allowed revenue; East Midlands approximately -£2m or -0.5% of allowed revenue; South Wales approximately £4m or 1.7% of allowed revenue; and South West approximately £0.5m or 0.2% of allowed revenue.

The introduction of DCP228 in 2018/19 charging year is set to reduce the Domestic charges by 10% to 15% and reappropriate the revenue to other customers.

We have considered these other situations when developing a proportionate response to this current position.

### **Proposed Solution**

Our initial proposal, submitted on 1 December, was to issue corrected 2017/18 prices, but with 3 months notice.

In response to this proposal Ofgem asked WPD to go back and think further about how the customer detriment could be better solved without changing the 15 months' notice period.

WPD came up with five solutions in December 2016 which are detailed in the derogation request sent on 21<sup>st</sup> December 2016.

WPD continued to consider Ofgem's comments further, and in January 2017, developed Option 6B which looks to fully mitigate all customer detriment.

### **Option 6B**

We proposed option 6B at our meeting on 19<sup>th</sup> January with Andrew Wright. The process is as follows:

1. Re-run 2017/18 tariffs using the corrected NUFs. This includes the EDCM tariffs, the CDCM tariffs, the CDCM IDNO Tariffs, and the EDCM IDNO tariffs.
2. Subtract the 2017/18 tariffs published in December 2015 from the new set of tariffs created in step 1). This would highlight the customers who would have been over or under charged as a result of the issue with the formula.
3. These differences will be multiplied by two years of forecast RPI to adjust for the time value of money.
4. In December 2017 WPD would then run the 2019/20 tariffs as normal, but before publishing these WPD would add the difference between the 2017/18 corrected tariffs and the published 2017/18 tariffs to the 2019/20 tariffs.
5. Issuing an addendum, correcting the 2017/18 prices for the sixteen EDCM customers who face being overcharged by more than 1% and £1000 of their DUoS bill.

This process would completely correct the misallocation of revenue between EDCM and CDCM customers whilst providing suppliers and most large industrial customers with the required notice of price changes. It would also deal with the issues created by new methodologies.

Whilst it should be noted that this option does not preserve the 15 month notice period for all customers, the sixteen customers with reissued prices for 2017/18 all show reductions in their prices. Further, these customers are likely to be on pass-through contracts and therefore will feel the benefit immediately. The addendum for 6B will be correcting pass through prices to a handful of large customers by reducing their prices. There is therefore no detriment to them.

Ofgem rejected WPD's request to issue all revised 2017/18 prices at the start of December 2016 as they were also concerned about additional price volatility for those EDCM customers who will be undercharged in 2017/18, preferring repricing in 2019/20 as a result of a "catch-up effect" in that year.

We propose to contact affected EDCM customers in April 2017 to advise that 2017/18 bills will be corrected in 2019/20, providing them with 24 months' notice.

## Dealing with the error

WPD identified this issue at the end of November 2016. It was discovered through the investigation into a customer's NUF which had changed in an unexpected way year on year. WPD immediately notified Ofgem of the issue with a proposal for a solution to re-price 2017/18 tariffs, giving the customers and suppliers three months' notice. Due to the introduction of DCP178 effective from 5th November 2015, 15 months' notice is now required, subject to the provision for Ofgem to grant a derogation.

We acknowledge that our first proposal did not meet the 15 month notice period required by Ofgem in DCP178. Hence whilst we proposed a solution on 1st December 2016 we continued to consider options which would correct the position without requiring additional changes to charges in March 2017.

However, we note that when the 15 month notice period was approved on 24<sup>th</sup> February 2015 for implementation on 5<sup>th</sup> November 2015, paragraph 19.1B was inserted into the DCUSA document as a failsafe to apply in the circumstance where either a manifest error has occurred or a DNO has forecast inaccurately enough to cause significant detrimental impact to their business.

Paragraph 19.1B of the DCUSA document states:

*19.1B The periods of notice described in Clause 19.1A shall apply unless the Authority directs the Company that those periods of notice need not apply. Where the Authority directs the Company that those periods of notice need not apply, the notice period shall be 40 days (without prejudice to any longer notice requirements prescribed by the Distribution Licence).*

The DCP178 change report also contained provision for this. Paragraph 6.22 states:

*6.22 Where an error does occur, a DNO can request a derogation from Ofgem seeking permission to publish a revised set of tariffs, although the Working Group noted that the impact would need to be significant for Ofgem to approve such a change. With DCP 178 in place tariffs would be calculated and published sooner, therefore, increasing the likelihood that errors could be identified and rectified earlier rather than later.*

In light of these statements we originally proposed a solution for April 2017/18 with four months' notice.

We note that other DNOs have previously been granted derogations to correct pricing errors, for example, Northern Powergrid, when losses were incorrectly entered in the model; SSE, where reactive power was entered incorrectly; and Northern Powergrid, most recently within RIIO ED1 where wrong IDNO data was input for the wrong DNO.

We understood that it was not Ofgem's policy to impose penalties for errors made when calculating charges, as set out in Ofgem's "Decision in relation to measures to mitigate network charging volatility arising from the price control settlement" published on 17 October 2012. Paragraph 2.47 states "We do not intend to introduce a penalty for errors made when calculating charges as part of this decision", and gives the reasons that Ofgem considers that imposing a penalty on a charging error would be disproportionate to the issue.

As we have set out in this letter we intend to correct the position by 2019/20 that will allow 24 months notice to the vast majority of customers. The small number of customers who will receive shorter than expected notice of the change are all receiving a reduction and not an increase. Having said that we acknowledge that there was an error and in recognition of the issue we propose to make a voluntary goodwill payment to charities of £300,000 that will assist fuel poor customers in South Wales and the South West.

The specific charities are the Centre for Sustainable Energy (CSE) in Bristol who will receive £150,000 and Energy Savings Trust (EST) in Wales who will also receive £150,000. Both organisations are independent from WPD and would use the money on fuel poverty projects. As EST are a National Organisation WPD would require the donation to be used to support Welsh Customers within our geographic footprint.

### **Lessons Learned**

The charging methodologies are an extremely complex system of processes. Indeed we welcome Ofgem's intention to look again at the charging arrangements to look at ways to simplify the process.

In the meantime we are working with Internal Audit to put in place additional controls and assurance around the data provided to our pricing team, particularly when there are changes to the underlying codes and equations which form the methodology.

### **Conclusion**

Despite a significant level of checking performed each year, we recognise that we have made a pricing error with regard to the 2017/18 prices due to take effect this coming April for customers in South Wales and the South West. The overall impact is less than 1% of allowed revenue. Due to the new requirement for 15 months' notice Ofgem's view is that the error should be corrected in 2019/20.

The error affects CDCM customers by less than 1% of their bill, and will be offset by the forecast k factor position. The majority of EDCM customers are also affected by less than 1% of their bill in 2017/18, and which may also be offset by the forecast k factor position. These prices can be corrected in 2019/20.

16 out of 479 customers would be overcharged by more than 1% and £1,000. We propose to follow option 6B set out in this letter which will also correct these in 2017/18 via an addendum.

55 EDCM customers will be undercharged by more than 1% and £1,000. We propose to correct the underpayment in 2019/20 and advise these customers in April 2017, thus providing two years' notice. EDCM prices are volatile year on year due to the EDCM methodology. Some customers will also see an off-setting price reduction in 2019/20, however it is not possible to predict which ones this will be.

The additional package of goodwill measures will be funded directly by WPD's shareholders.

**Summary Of Derogation Request.**

WPD would like to request the following derogations to enable correction of the prices using Option 6B.

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) AND a derogation under SLC 14.12(a) to amend prices less than 3 months' notice.

A derogation under SLC13B Part E, to price outside of the EHV DUOS pricing methodology specifically in terms of the NUFs calculation for 2017/18 and 19/20 site specific prices.

A derogation under SLC13A Part E, to price outside of the CDCM DUOS pricing methodology for 2017/18 and 19/20.

We hope that this proposal draws a satisfactory conclusion to the current position.

Yours sincerely



ALISON SLEIGHTHOLM  
Regulatory & Government Affairs Manager