

Last Resort Supply Payment – February 2018 Update

In November 2016, GB Energy Supply Limited ceased trading. Ofgem subsequently appointed Co-operative Energy Limited as the Supplier of Last Resort for GB Energy Supply Limited's gas and electricity customers. In taking on GB Energy Supply Limited's customers, Co-operative Energy Limited also took on some liabilities, including any credit balances which customers of GB Energy Supply Limited held at the time of failure.

On 16 November 2017, Ofgem published a minded to decision on Co-operative Energy Limited's request to make a claim for a Last Resort Supply Payment to enable Co-operative Energy Limited to recover costs associated with their appointment as the Supplier of Last Resort, requesting representations from industry on its decision.

On 19 January 2018, Ofgem approved to Co-operative Energy Limited making a claim of £14.0m for a Last Resort Supply Payment. Under the standard conditions of the electricity supply licence (condition 9), the Supplier of Last Resort must make any such claim from gas and electricity distributors. Electricity distribution network operators are collectively liable for 55% of the total claim, and on 25 January 2018, Electricity North West Limited received a claim for £0.6m.

Under the standard conditions of the electricity distribution licence (condition 38), a distributor receiving a valid claim for a last resort supply payment must increase its UoS charges in the Relevant Regulatory Year (as defined in SLC38), being the next regulatory year if the claim is received more than 60 days prior to the start of that year. As Electricity North West Limited received a valid claim more than 60 days prior to the start of 2018/19, UoS charges must be increased in 2018/19 to recover the amount of the valid claim.

Ofgem has directed that the 15 months' notice required of a change to UoS charges for 2018/19 need not apply in this case, and that we are allowed to alter our charges using a non-approved methodology. We have selected a charging methodology that will ensure our approach is consistent with other Distribution Network Operators and disruption to industry arrangements is minimised as much as possible.

The increase in fixed charges for these tariffs has been calculated as follows, rounded to two decimal places:

$$\text{Supplementary Fixed Charge (p/MPAN/day)} = \left(\frac{(A/B)}{C} \right) \times 100$$

Where:

A = Amount to be recovered, being £620,480.33

B = Total combined forecast (from published CDCM model for 2018/19) domestic unrestricted, domestic two rate and LV network domestic customers, being 2,262,630

C = Days in the year, being 365

The resulting 0.08p/MPAN/day increase in fixed charge for the aforementioned customers has been applied in our Charging Statement, and hence the tariffs published in this statement do not mirror either those originally published in December 2016, nor those in the published CDCM model for 2018/19. All other tariffs remain unaltered from the original December 2016 publication.

Annex 1: Ofgem consent given by the Gas and Electricity Markets Authority pursuant to Standard Condition 9 (Claims for Last Resort Supply Payment) of the Electricity Supply Licence treated as granted under section 6 of the Electricity Act 1989 to Co-operative Energy Limited

Consent given by the Gas and Electricity Markets Authority pursuant to Standard Condition 9 (Claims for Last Resort Supply Payment) of the Electricity Supply Licence treated as granted under section 6 of the Electricity Act 1989 to Co-operative Energy Limited

To: Co-operative Energy Limited (Company Number 06993470)

Whereas:

- A. Co-operative Energy Limited ("the Licensee") is the holder of an electricity supply licence ("the Licence") granted or treated as granted under section 6(1)(d) of the Act.
- B. The Gas and Electricity Markets Authority ("the Authority") issued the Licensee with a direction to supply electricity to the customers of GB Energy Supply Limited with effect on and from 30 November 2016 under paragraph 1 of standard condition 8 of the Licence ("Last Resort Supply Direction")¹.
- C. The Licensee gave notice to the Authority on 13 November 2017 of its claim for a payment to compensate for any additional costs it incurred in complying with a Last Resort Supply Direction (a "Last Resort Supply Payment") under standard condition 9.3 of the Licence.
- D. Standard conditions 9.5 and 9.6 of the Licence state that the Authority will give its consent for the Licensee to make the claim notified to it if it considers it appropriate in all the circumstances of the case or, within three months after it has been notified of the claim, the Authority may determine that an amount other than the one calculated by the Licensee is a more accurate calculation of the relevant amount for the Last Resort Supply Payment.
- E. The Authority consulted on its determination of the amount it considered appropriate for the Licensee to recover.
- F. The Authority has made a final decision on the relevant amount it will consent for the Licensee to recover as a Last Resort Supply Payment, taking into account representations from interested parties. The reasons for the Authority's decision can be found in its decision document².

Therefore:

- G. Pursuant to standard condition 9.6 of the Licence, the Authority hereby consents for the Licensee to claim for a Last Resort Supply Payment of up to £7,721,881 from the relevant distributors. Pursuant to standard condition 9 of the Licence, relevant distributors are electricity distribution licensees in whose distribution areas there were premises supplied under the Last Resort Supply Direction, excluding independent distribution network operators. This amount shall be reduced by 55% of any amounts the Licensee recovers from the liquidation of GB Energy Supply Limited.
- H. This consent shall take effect on and from 19 January 2018.

¹ <https://www.ofgem.gov.uk/publications-and-updates/direction-appoint-cooperative-energy-electricity-supplier-last-resort>

² <https://www.ofgem.gov.uk/publications-and-updates/last-resort-supplier-payment-claim-co-operative-energy>

Dated: 19 January 2018

Signed

Lesley Nugent

Head of Industry Codes and Licensing

Duly authorised on behalf of the Authority

Annex 2: Ofgem decision on Last Resort Supply Payment Claim from Co-operative Energy



Making a positive difference
for energy consumers

Gas and Electricity Suppliers,
Electricity Distribution Network
Operators, Gas Transporters and
all other interested parties

Direct Dial: 020 7901 7034
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Date: 19 January 2018

Dear colleague

Decision on Last Resort Supply Payment Claim from Co-operative Energy

On 16 November 2017, we¹ published our minded-to position on Co-operative Energy Limited (**CEL**)'s intention to claim for a Last Resort Supply Payment (**LRSP**) additional costs they incurred in acting as a Supplier of Last Resort (SoLR).² We received 13 responses to our consultation. This letter confirms our decision to consent to CEL claiming a LRSP of up to £14.04m³. We also explain any additional factors we have taken into consideration, including representations made to us by interested parties in response to our consultation.

Our decision will allow CEL to recover a portion of the costs of protecting the credit balances owed by GB Energy Supply Limited (GBES) to the customers CEL acquired in line with commitments given at the time of appointment, and certain other costs incurred by CEL in complying with Ofgem's Last Resort Supply Direction (**LRSD**)⁴. We do not consent to CEL's request to include in its claim up to a further £0.86m, to cover IT migration costs which they consider were incurred in the course of acting as a SoLR. Our decision will enable CEL to recover up to £14.04m subject to the outcome of the GBES administration process (discussed further below).

In taking this decision, we have had due regard to Ofgem's principal objective of protecting the interests of current and future energy consumers,⁵ the relevant provisions of CEL's gas and electricity supply licences,⁶ Ofgem's "Guidance on supplier of last resort and energy supply company administration orders" (our "**Guidance**"),⁷ the terms of the LRSD and the particular circumstances of compliance with the LRSD.

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. This decision is made by or on behalf of GEMA.

² <https://www.ofgem.gov.uk/publications-and-updates/last-resort-supplier-payment-claim-co-operative-energy>

³ Precisely, £14,039,783.

⁴ The LRSD consists of two documents, both dated 30 November 2016 and available here:

<https://www.ofgem.gov.uk/publications-and-updates/direction-appoint-cooperative-energy-gas-supplier-last-resort> and <https://www.ofgem.gov.uk/publications-and-updates/direction-appoint-cooperative-energy-electricity-supplier-last-resort>. Both directions entered into effect at 00:01 on 30 November 2016 and continued in force for a period of six months.

⁵ See section 3A of the Electricity Act 1989 and section 4AA of the Gas Act 1986.

⁶ See standard licence conditions 8 and 9 of both CEL's gas and electricity licences.

⁷ This was published on 21 October 2016 and is available here:

https://www.ofgem.gov.uk/system/files/docs/2017/09/solr_revised_guidance_final_21-10-2016.pdf. This guidance was supplemented with a decision on our approach to dealing with supplier insolvency and its consequences for consumers, which was published on the same day and is available here: <https://www.ofgem.gov.uk/ofgem-publications/105387>.

Background

The SoLR process

Electricity and gas is supplied through markets and on the basis of a competitive process in Great Britain. While competition has the potential to bring many benefits to consumers, a competitive process occasionally leads to companies failing. This applies as much in relation to the gas and electricity supply markets as it does to other markets.

When a supplier fails, our focus is to ensure continuity of supply for its customers and to avoid wider negative effects on the market. Such wider effects stem from the fact that, in practice, until the failed supplier's contracts have been transferred, or deemed contracts are established with a SoLR, there would be no practical way to prevent an existing customer from taking electricity or gas from the network. This will cause the network system operator to step in to perform a residual role of balancing the gas and electricity in the network. As the failed supplier will not be able to pay for the energy required to balance the networks in this way, these costs will fall to be mutualised across other industry participants. There is also the real risk that if a supplier fails without urgent intervention, consumer trust and confidence in the energy market would be materially damaged.

Ofgem can ensure continuity of supply to the failed supplier's customers and prevent these wider negative effects by appointing a SoLR to supply the failed supplier's customers at very short notice.⁸

The LRSP process

Once appointed, a SoLR may make a claim for a LRSP from relevant distribution networks where we have given our consent to the amount claimed. In November 2017, CEL notified us of its intention to claim for a LRSP consisting of the following elements:

- Item 1: Recovery of 70% of GBES customers' net credit balances (£10,979,815)
- Item 2: Emergency wholesale procurement (£1,269,801)
- Item 3: Cost of capital to fund credit balances (£1,790,167)
- Item 4: IT migration costs (£859,300)

The cost of protecting customers' credit balances has been partly (30%) funded by CEL.

In our November 2017 letter, we explained that we were minded-to consent to CEL claiming for items 1-3 only, and the factors behind our decision. For item 1, we intended to consent to CEL claiming the amount it requested from relevant distribution networks, appropriately adjusted, to take into account any sums awarded to CEL through the liquidation of GBES.

Our decision

We received 13 responses to our consultation, which we have summarised in the Appendix⁹. We received no representations that have led us to change our minded-to position.

⁸ The obligation for a supplier (such as CEL) to comply with a LRSD derives from standard licence condition 8 of each supplier's the gas and electricity supply licences and is intended to ensure a universal service for Great British energy consumers (for further information on this universal service, see Articles 3(3) of the EU Directives 2009/72/EC and 2009/73/EC). The duties of a SoLR are further described in our Guidance and the LRSD contains specific details of CEL's obligations to supply GBES' customers.

⁹ Non-confidential responses have been published on our website alongside this decision document.

Taking into account all of the information available to us and the specific circumstances of this case (which was the first SoLR process for 8 years and the first time the LRSP process has been tested), we consent to CEL claiming a LRSP of up to £14.04m¹⁰, subject to any amounts CEL is awarded through the liquidation of GBES.

We are making this decision in light of the broader market considerations and our wider statutory duties to protect both existing and future consumers. We acknowledge that this is an area that warrants further consideration and going forward in any future SoLR situation we would require suppliers seeking to be appointed the SoLR to provide additional information about their intentions regarding the recovery of any costs through any potential LRSP claim. We may also update our published SoLR guidance, to clarify our expectations of suppliers bidding to be appointed a SoLR and to help inform them as they prepare their bids.

We are satisfied that items 1, 2 and 3 represent no more than (and, indeed, only account for a proportion of) the total costs incurred by CEL in complying with Ofgem's LRSD, minus the total amounts recovered by CEL from GBES' former customers.¹¹ We note that CEL has excluded a number of costs from its claim, and, for example, has agreed not to claim for 30% of the costs of honouring GBES' customers' credit balances.

For the avoidance of doubt, we consider on a case-by-case basis whether it may be appropriate for any SoLR to make a claim for a LRSP and whether the costs it has incurred in discharging its duties under a LRSD are efficient. This should not be taken as setting a precedent for any future claims, which would also be considered on their merits and on a case-by-case basis, taking into account all relevant circumstances of the particular case.

The amount we consent to CEL claiming from relevant gas and electricity distribution networks¹² respectively will be allocated in proportion to the total number of nationwide gas and electricity supply points, as reflected in our directions to CEL under its gas and electricity supply licences. We consider this apportionment to best enable broad socialisation of the claim costs in line with the intent of the SoLR regime to protect all consumers in the market, for example, through limiting the extent of unpaid industry bills of a failing supplier.

As per the supply standard licence conditions regarding LRSP claims¹³, CEL will be able to submit a claim to each relevant distribution network, based on the amounts we have consented to and each network's share of the total premises served by the relevant networks, in each fuel respectively. We expect CEL to do this on the basis of the data on customer numbers contained within the network companies' regulatory reporting packs. This has the advantage of being a data source that is transparent and consistent between gas and electricity.

Recovery of CEL's claim through network charges:

In our November letter, we consulted on recovery of any amount that we consent to CEL claiming, through network charges in 2018/19. On balance, we consider it appropriate for networks to recover the costs of LRSP made to CEL through charges from April 2018.

We recognise that there may be administrative inefficiencies of a one-off adjustment to charges for networks and their customers and broader benefits of giving network users more notice of the changes to their charges, by delaying charging adjustments to a later year. In addition, stakeholders have identified inconsistencies between network licence

¹⁰ Precisely, £14,039,783.

¹¹ This is the test set out in standard licence condition 9.4 of CEL's gas and electricity supply licences.

¹² The relevant distributors according to standard licence condition 9 of the electricity and gas supply licences are distributors in whose distribution areas there were premises supplied under the Last Resort Supply Direction, excluding independent distribution network operators and independent gas transporters

¹³ Standard licence condition 9

obligations regarding LRSP claims and broader network price control and charging regulatory obligations. We recognise that it may be beneficial to review both the supply and network licence conditions in relation to LRSP claims, in particular in relation to the timings and process for how claims are to be made and treated. However, given the timing of CEL's claim, and the low materiality of the costs relative to average network charges per customer, we consider it appropriate for distribution networks to comply with their licence obligations (to adjust their charges for start of the next regulatory year for any valid claim for a LRSP received during January) and recover the costs of making payments to CEL in 2018/19 from their customers through adjusting their charges from April 2018.

Broader points

As per our decision to use the SoLR arrangements as a safety net for consumers' credit balances, we consider this to be the option that is in the best interests of all consumers. We intend to keep this position under review as the retail market evolves based on the effectiveness of the arrangements in protecting customers of an insolvent supplier, ensuring value for all consumers, and maintaining confidence in the retail market.

We also acknowledge contributions from interested parties on our approach to financial regulation. We understand the importance of maintaining confidence in the market, and our consideration of the timing of any future review of our approach to licensing suppliers will take this into account, amongst other factors, including any implications of our planned work on reviewing the appropriateness of the broader regulatory framework for energy suppliers.

Yours faithfully,

Rob Salter-Church
Partner, Consumers and Competition

Appendix - Consultation responses

We received 13 responses to our letter, from suppliers, distribution networks and a consumer body.

Amount of CEL's claim

6 respondents supported our minded-to decision, with parties expressing views that our decision appeared consistent with commitments and expectations that CEL may have legitimately had during the appointment process, and supporting our approach to assessing the CEL's request. There was broad support amongst all respondents who commented on the amount of the claim, for our intention to consent to CEL claiming for Item 1 (recovery of 70% of GBES consumers' net credit balances), and our intention to exclude Item 4 (IT system migration costs) from the claim.

4 respondents specifically disagreed with allowing CEL to recover Item 2 (emergency wholesale procurement costs), on the grounds that these costs would have been expected at the time of SoLR appointment based on the information available at the time, and any risk of wholesale prices exceeding expected costs due to market volatility ought to have been factored into CEL's commitments at the time of bidding. These respondents highlighted the negative impact of consenting to CEL recovering these cost items through a LRSP on the effectiveness of the SoLR arrangements in protecting the interests of all consumers.

2 respondents specifically disagreed with allowing CEL to recover Item 3 (cost of capital), on the grounds that these costs would have been similarly predictable and ought to have been factored into CEL's commitments at bid. On the other hand, 2 suppliers considered these costs to be so closely related to the costs of protecting credit balances that they can be considered implicitly within the commitments CEL made at bid regarding funding credit balances through absorbing the costs and making a claim for a last resort supply payment.

Recovery of CEL's claim through network charges

Notice period for network charge adjustments

4 suppliers and one distribution network expressed concerns that the implication of our intention to make a final decision on CEL's claim in January that distribution network charges would be adjusted from April 2018, given that this leaves a short notice period relative to usual arrangements for setting network charges. These respondents suggested that this would create undue administrative burden and/or financial impacts, and that the LRSP arrangements are out of step with expectations from suppliers and shippers for predictable pricing. The 4 suppliers in question requested that network charge adjustments be delayed, for example, until 2019/20 or to allow for a full 15 months' notice period for charge adjustments in line with Distribution Code and Use of System Agreement (**DCUSA**) obligations for Use of System charges in electricity.

Allocation of CEL's claim across networks and their customers

The distribution networks who responded summarised their charging proposals to allocate the costs of any claim submitted to them by CEL amongst their customers. The electricity distribution networks in particular explained that their common charging proposal across the DNOs aimed to limit the consequential impacts on suppliers given the short notice period for adjusting charges, and to limit the potential for under or over collection of revenue from charges, in light of the time limits for making charge adjustments related to last resort supply payment claims in their licence conditions. The gas distribution networks also suggested that CEL's claim should be allocated to gas and electricity networks, respectively, based on the proportion of total supply points nationwide for each fuel.

Improvements to the process

Two respondents suggested further details were required within the regulatory framework on how distribution networks should adjust their charges to recover the costs of a LRSP to create clarity and transparency for stakeholders.

Two distribution networks suggested that Ofgem consider introducing a formal recovery mechanism within their allowed revenue licence conditions. Another distribution network suggested that for future last resort supply payment claims, Ofgem should review the last resort supply payment obligations in the distribution network licence in light of the 15-month notice period for adjusting Use of System charges in DCUSA.

One respondent also suggested that Ofgem review the process for last resort supply payments in order to minimise the potential for ongoing adjustment of network charges that may occur if a claim includes costs of protecting consumer credit balances, as a result of any ongoing liquidation of an insolvent supplier's assets.

Improving the SoLR appointment process

There was broad support from respondents for our acknowledgement that lessons can be learnt from last year's SoLR event and the first claim for a last resort supply payment. Respondents welcomed our commitment to consider revising our SoLR guidance, and some offered suggestions for how we should do this.

Two respondents suggested that suppliers' commitments to managing the costs of being a SoLR, including the costs of protecting credit balances, should be prioritised over protecting customers of an insolvent supplier financially in any SoLR appointment process given the redistributive effects of the levy and the potential for moral hazard amongst suppliers and their customers. Three respondents suggested Ofgem clarify its expectations on the circumstances in which claims under levy would be considered in order to facilitate confidence in the SoLR arrangements going forward.

Broader points

Two points were raised in relation to Ofgem policies regarding supplier financial issues that are broader in scope than the issues we put forward in our consultation. Two respondents raised questions on the legal basis and the policy impacts of using the last resort supply payment arrangements to protect consumer credit balances in the event of supplier insolvency. Three respondents suggested Ofgem review its approach to licensing suppliers to ensure their financial and/or operational capability and its approach to monitoring their performance in order to inform proactive regulatory intervention and provide incentives to entrants in the market to be financially responsible.

Annex 3: DNO request for formal directions in relation to the distribution connection and use of system agreement and certain requirements of standard condition 13 of the electricity distribution licence in respect of Co-operative Energy Limited's last resort supply payment claim.

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01 February 2018

Dear Chris

Request for formal directions in relation to the distribution connection and use of system agreement and certain requirements of standard condition 13 of the electricity distribution licence in respect of Co-operative Energy Limited's last resort supply payment claim.

We are writing to request the necessary directions to allow distribution network operators (DNOs) to recover the costs associated with Co-operative Energy Limited's (CEL's) last resort supply payment (LRSP) claim as defined in standard condition 38 of the electricity distribution licence (hereafter "SLC38" – see appendix 1).

Further to Northern Powergrid's 10 November 2017 letter (see appendix 2), we are requesting that Ofgem provides:

- consent under clause 19.1B of the distribution connection and use of system agreement (DCUSA) that the periods of notice described in clause 19.1A of the DCUSA need not apply; and
- consent for electricity distribution licensees to charge other than in accordance with the charging methodologies approved under standard condition 13 of the electricity distribution licence (hereafter "SLC13").

For the avoidance of doubt this request is made on behalf of, and the requested directions should apply to, the 14 licensees that are Distribution Services Providers (as defined in the electricity distribution licence).

It is necessary that the requisite consents apply to both the Relevant Regulatory Year (as defined in SLC38) and the year following the Relevant Regulatory Year in the event of any shortfall or excess revenue derived from the consequential increase in use of system (UoS) charges as described in SLC38.

CEL's LRSP claim was received by DNOs on 25 January 2018. As this date was more than 60 days prior to the start of 2018/19, the Relevant Regulatory Year for the purposes of SLC38 is the year commencing on 1 April 2018, and therefore the year following the Relevant Regulatory Year is the year commencing on 1 April 2019.

Background

On 29 November 2016, Ofgem appointed CEL as the supplier of last resort (SoLR) to the gas and electricity customers of GB Energy Supply Limited (GBES) following GBES's failure. At the time of failure, GBES held credit balances in respect of a number of its customers, which were subsequently transferred to CEL.

CEL submitted a claim primarily to recover 70% of the credit balances which were transferred to it as part of its appointment as the SoLR. Ofgem published its minded to decision¹ on 16 November 2017, outlining that it was minded to consent to CEL claiming a LRSP of up to £14.04m.

Under standard condition 9 of the electricity supply licence (hereafter "SLC9" - see appendix 3), CEL may make a claim from each electricity distribution licensee which distributed electricity to customers that GBES supplied at the time of failure. The total LRSP will be split between the relevant distributors (i.e. those who had premises supplied by GBES connected to their networks at the time of failure) in proportion to their combined total customer numbers.

In its final decision², published on 19 January 2018, Ofgem has determined the value of CEL's claim to be £14.04m³, of which electricity distribution licensees will collectively be liable for £7.72m⁴ (55%). At the time of failure, GBES supplied electricity to customers in all 14 electricity Distribution Services Areas (as defined in the electricity distribution licence), and the total claim to be recovered by electricity distribution licensees has been split between the 14 licensees in proportion to the total customer numbers contained within their respective 2016/17 regulatory reporting packs.

Under SLC38, a distributor receiving a claim for a LRSP must increase its UoS charges in the following regulatory year (if the claim is received more than 60 days before the start of the regulatory year) or the year after (if the claim is received less than 60 days before the start of the regulatory year) to recover the amount of the claim plus interest.

As CEL submitted their LRSP claim before 31 January 2018 (i.e. more than 60 days before the start of 2018/19), DNOs must increase their UoS charges in 2018/19 (i.e. effective from 1 April 2018). In due course, each DNO must calculate the revenue it has derived from the increase to its 2018/19 UoS charges, and determine whether there is a shortfall or excess to the revenue targeted (the Specified Amount as defined in SLC38). Any such shortfall or excess must be corrected by a change to its UoS charges in the following regulatory year (i.e. 2019/20). SLC38 provides no means for any outstanding shortfall or excess remaining at the end of the second year to be corrected.

Issue one (notice periods)

Paragraph 11 of standard condition 14 of the electricity distribution licence (hereafter "SLC14") requires a distributor to give three months' notice of a change to its UoS charges. This requirement is referred to in SLC38, which states (in paragraph 8) that the requirements of SLC38 apply even if the distributor has not provided the 'Notice' required under SLC14.

In addition, under the DCUSA a distributor is required to give 15 months' notice of a change to its UoS charges. This is a contractual requirement that applies in addition to any licence obligations. In accordance with this requirement, UoS charges for 2018/19 were published in December 2016, and for 2019/20 in December 2017. Therefore, as a result of the requirement to give 15 months' notice of a

¹ https://www.ofgem.gov.uk/system/files/docs/2017/11/last_resort_supplier_payment_claim_from_co-operative_energy_002.pdf

² https://www.ofgem.gov.uk/system/files/docs/2018/01/last_resort_supply_payment_claim_from_co-operative_energy_final_decision.pdf

³ Precisely, £14,039,783

⁴ Precisely, £7,721,881

change to UoS charges, charges for both the Relevant Regulatory Year and the year following the Relevant Regulatory Year has been published by DNOs.

Although SLC38 makes it clear that the notice periods stipulated in the electricity distribution licence do not apply in respect of changes to UoS charges to recover a LRSP claim, this does not alter the obligations as to notice under the DCUSA.

In making this request we should make reference to a further complication that arises from an apparent inconsistency between the DCUSA and SLC38. Clause 19.1D of DCUSA allows the distributor to vary 'Other Charges' without giving the same notice as is required when UoS charges are being varied. Moreover, clause 19.2.1 of DCUSA defines Other Charges to include the charges necessary to deal with a SoLR claim. However, SLC38 requires that the licensee shall respond to a valid SoLR claim by varying its UoS charges. Unless the term 'Use of System Charges' has a different meaning in the DCUSA and the electricity distribution licence there is a contradiction here that we think has probably gone unnoticed before now. In such circumstances of ambiguity licensees need certainty that there will be neither regulatory nor contractual repercussions from the imposition of charges that are properly designed to recover the appropriate amount of a SoLR claim.

Issue one - direction sought

A direction is therefore required under clause 19.1B of the DCUSA that the periods of notice described in clause 19.1A of the DCUSA (15 months) shall not apply, and this direction must cover both the Relevant Regulatory Year and the year following the Relevant Regulatory Year i.e. 2018/19 and 2019/20. Breach of the DCUSA is also a licence breach, but fortunately the DCUSA makes provision for Ofgem to give directions to this effect.

We would like to point out that even with the direction sought, under clause 19.1B of the DCUSA DNOs will still be required to provide 40 days' notice of the changes. We therefore request that this issue be dealt with as swiftly as possible in order to allow DNOs sufficient time to produce any revised statements required and carry out proper assurance.

Issue two (charging methodology)

Paragraph two of SLC14 requires electricity distribution licensees to set their UoS charges in line with the relevant charging methodology, being the common distribution charging methodology (CDCM) and extra-high-voltage distribution charging methodology (EDCM), both of which are detailed in the DCUSA. SLC38 does not specify any methodology by which an increase to UoS charges should be calculated and applied.

Various options have been assessed specifically in relation to the CEL LRSP claim, primarily against three criteria:

1. **Equitability** in respect of the customers who have benefited from, and would be contributing to the recovery of costs associated with, the protection provided by the SoLR process;
2. **Volatility** in respect of the likely quantum of any shortfall or excess at the end of the Relevant Regulatory Year (i.e. 2018/19); and
3. **Practical considerations** such as simplicity, predictability, transparency and timeliness of implementation, and primarily in the context of necessary directions and/or requisite licence changes.

An options paper can be found in appendix 4. Please note that this working paper was drafted and reviewed by all DNOs in advance of CEL submitting their claim to assess the various options against the criteria, therefore any quantitative assessment does not necessarily align to that in this letter.

DNOs collectively agreed that, in respect of CEL's LRSP claim, a supplementary fixed charge applied to residential customers is most appropriate, which when assessed against the other options in relation to the practical considerations of implementation, represents the best, and potentially only, feasible solution.

During this process Ofgem raised concerns in respect of the difficulties associated with the ability of some independent distribution network operators (IDNOs) to pass through the proposed increase in UoS charges to their customers, specifically in the context of the concerns identified with this maiden LRSP claim and the tight timescales the industry is working toward.

The DNOs acknowledge the basis of Ofgem's preference to exclude customers connected to IDNO networks from the cost recovery methodology proposed in respect of CEL's claim. Whilst this approach is not aligned to the principle of equitability in the context of the protection the SoLR process provides to consumers (including those connected to IDNO networks), the DNOs agree with Ofgem's proposal such that the respective CEL claims will be recovered only from residential customers connected directly to each DNO's network. This agreement is predicated on the basis that:

- Ofgem is not setting a precedent for future LRSP claims;
- Ofgem is clear in, and will enforce, its expectation that the IDNOs will not subsequently increase their UoS charges up to the charge which the relevant DNO will levy on customers directly connected to that DNO's network in the Relevant Regulatory Year, and, where appropriate, in the year following the Relevant Regulatory Year, specific to CEL's claim;
- Changes to licence conditions will be explored and progressed in line with the enduring solution outlined in this letter and applied in future LRSP claims as soon as is practicable; and
- Any changes to licence conditions will facilitate bad debt cost recovery by the DNOs that is associated with UoS charges owed by electricity suppliers who have ceased trading.

Regardless of the option taken forward, there may be a shortfall or excess in the revenue derived from the increased UoS charges relative to the amount targeted (the Specified Amount). A supplementary fixed charge approach will minimise any variance, which will in turn result in a smaller impact on published final 2019/20 UoS charges.

In respect of UoS levied by DNOs fixed charges are not applicable to all tariffs (i.e. unmetered suppliers and generators).

Fixed charges are rounded to two decimal places of a penny in the charging methodologies. As a result, depending on the upper and lower limits, the threshold beyond which the correctional charge in the year following the Relevant Regulatory Year would be required is potentially relatively high, with an average absolute tolerance of approximately 6% on residential customer numbers in the Relevant Regulatory Year for a non-zero supplementary fixed charge to be required to correct any shortfall or excess in the year following the Relevant Regulatory Year. It is worth noting that this is relative to each licensee and ranges from 3% to 11%.

Customer counts do not vary materially on an annual basis, unlike units distributed. Recovery of the LRSP claim via a volumetric charge would arguably provide a stronger cost signal for consumers who have the means to reduce overall consumption. This would be logical if the costs these additional charges are

seeking to recover could be reduced by a decrease in consumer demand, which is clearly not the case. Further, consumer demand is relatively volatile, and actual consumption will not be fully determined until the settlement reconciliation process reaches completion 14 months after the consumption date (i.e. 31 May 2020 for consumption on 31 March 2019), which therefore creates the potential for a further significant imbalance with no correction mechanism in place by which it can be remedied.

All customers benefit from the protection provided by the SoLR process and therefore an equitable cost allocation would arguably require all customers to contribute to the LRSP cost recovery. However, at the time of failure the vast majority (99.4%) of GBES' customers were residential (see appendix 5), and the majority of those were domestic unrestricted customers (93.9%). Recovering costs driven by residential customers from only residential customers prevents other (e.g. industrial and commercial) customers from cross-subsidising residential customers, especially when larger customers are less likely to hold credit balances with energy suppliers, and so are less likely to benefit from the SoLR process at any time. DNOs consider that applying the supplementary fixed charge to residential customers only is a more equitable means of recovering the LRSP claim, and recognising concerns raised by Ofgem the charge will only be applied to customers connected directly to each DNO's network.

The majority of DNOs favour applying the supplementary fixed charge to all residential customers rather than domestic unrestricted customers only, which has a similar benefit of both simplicity and predictability, but also does not sacrifice some cost reflectivity in that some residential customers (i.e. two rate and half hourly settled (i.e. LV network domestic)) would otherwise not be contributing to the recovery of costs relating to the protection mechanisms from which they may benefit in the future. This consideration may be applicable to other customer groups, but to a much lesser extent, and as acknowledged by Ofgem certainly applies in excluding customers connected to IDNOs, for which Ofgem has clarified it is not setting a precedent for future LRSP claims.

It has been acknowledged by the industry, notably at the November and December Distribution Charging Methodologies Development Group (DCMDG) and the November 2017 DCUSA Schedule 15 'Cost Information Table' teleconference, that a consistent DNO approach is favoured when calculating the necessary increase to UoS charges, and an option which changes charges for all customers is a significant administrative burden, and one which is not necessarily proportional to the benefit of a deemed increase in equitability.

The proposed approach to recovering CEL's claim has therefore been selected on the following grounds:

- Fixed charges provide a simple, transparent and predictable means to calculate, apply and track the necessary increase in UoS charges to recover costs which are not influenced by consumption and as such do not manifest in providing a stronger cost signal to be avoided.
- The reduction in volatility serves to better facilitate the recovery of CEL's claim, and in doing so mitigate the need for, and quantum of, a correction in 2019/20.
- Not all customers receive a fixed charge i.e. unmetered suppliers and generators.
- Residential customers dominate the DNO customer base, and specifically in relation to the customers transferred to CEL as the SoLR they represent >99%.
- In seeking to apply a fixed charge to non-domestic customers the resulting change in the supplementary fixed charge per customer is therefore marginal, in the context of a negligible absolute cost per customer in respect of CEL's claim.

- Due to the dominance of residential customers in respect of what is driving CEL's claim, and in consideration that these customers receive the greatest protection from the SoLR process, it was considered equitable to seek to recover the costs from the same customer group.
- Stakeholder engagement has highlighted both the need for DNOs to proceed using a common approach and a preference to avoid a need to change (already published) UoS charges for all customers. Stakeholders have generally been receptive to the proposal.
- Excluding residential customers connected to IDNOs has no impact on customers directly connected to DNO networks when rounding is accounted for in the calculation of the supplementary fixed charge. The net effect (subject to forecast customer numbers) is therefore a reduction in revenue which DNOs will recover in 2018/19 from the consequential increase in UoS charges, whilst still facilitating the reasonable recovery of CEL's claim in the period and a resulting smaller residual value as a result, which is an unavoidable product of rounding the tariff to two decimal places.
- DNOs have provided 15 months' notice of changes to UoS charges since those effective from 1 April 2017, having since published charges for both 2018/19 and 2019/20. Following the requirements of SLC38 forces DNOs to undermine this notice period, and where DNOs are seeking to do so in such a way that creates minimal disturbance whilst reasonably implementing an equitable cost recovery mechanism, whilst having an agreement but no mechanism in place to allow DNOs to recover their own bad debt costs associated with insolvent energy suppliers.
- The 15 months' notice required for a change to UoS charges provides considerable benefits which the requirements of SLC38 undermine, such as: improved forecasting and increased budget certainty, enabling consumers to better manage their costs; reduction in UoS risk-premium in all-inclusive supplier contracts for periods for which charges are published; providing consumers additional notice to 'shop around' for alternative agreements; and facilitating energy suppliers providing consumers with a wider range of tariffs (e.g. non-pass-through contracts for industrial customers).
- The CEL claim is the maiden LRSP claim, which has highlighted various flaws in legal drafting. The proposed approach provides CEL a means to reasonably recover their costs, whilst allowing DNOs to discharge their respective licence obligations subject to the consents this letter requests, which are explicitly within Ofgem's powers to provide.
- DNOs welcome the opportunity to work further with Ofgem to understand such areas of ambiguity and contradiction within legal drafting, whilst working towards a preferred enduring solution which would likely require changes to licence conditions, preserving the notice periods and ensuring the relevant parties are neutral to reasonably incurred costs.

Issue two - direction sought

Consent from Ofgem is requested to allow DNOs to charge other than in accordance with their charging methodologies as approved under SLC13, to allow the recovery of CEL's LRSP costs, in both the Relevant Regulatory Year (2018/19) and the year following the Relevant Regulatory Year (2019/20), via a supplementary fixed charge applied to all residential customers connected directly to each DNO's network. Paragraph 1 of SLC13 provides the vires for Ofgem to consent to the licensee departing from its approved charging methodology.

The proposed methodology for calculating the supplementary fixed charge in 2018/19 is outlined below, with Table 1 showing the Specified Amount each DNO is required to recover in respect of CEL's claim.

DNO	Total Number of Premises (000s)*	Proportion of Total Number of Premises	LRSP Claim Amount (£m)
ENWL	2,383	8.0%	0.62
NPg (Northeast)	1,601	5.4%	0.42
NPg (Yorkshire)	2,299	7.8%	0.60
SHEPD	767	2.6%	0.20
SEPD	3,033	10.2%	0.79
SP Distribution	2,004	6.8%	0.52
SP Manweb	1,509	5.1%	0.39
UKPN (EPN)	3,614	12.2%	0.94
UKPN (LPN)	2,330	7.9%	0.61
UKPN (SPN)	2,289	7.7%	0.60
WPD (East Midlands)	2,631	8.9%	0.68
WPD (South Wales)	1,128	3.8%	0.29
WPD (South West)	1,601	5.4%	0.42
WPD (West Midlands)	2,470	8.3%	0.64
Total	29,659		7.72

* Based on 2016/17 Regulatory Reporting Pack (RRP) submission (Cost and Volumes Pack Table M14)

Table 1 – Breakdown of total LRSP claim by DNO

The most transparent way to calculate the necessary charge per customer would be to utilise the forecast of customer numbers in the published CDCM model which relates to the Relevant Regulatory and, if necessary, the year following the Relevant Regulatory Year (published in December 2016 in respect of 2018/19 customer counts and in December 2017 in respect of 2019/20 customer counts). It would be possible to achieve a more accurate forecast using each DNO's latest internal forecast of customer numbers, but this would result in a need for each DNO to produce a new forecast, with a corresponding loss of transparency and simplicity, and where (in particular residential) customer numbers are not volatile, with steady growth expected in most regions. Hence, the slight loss of accuracy caused by the variance between the forecast for 2018/19 customer numbers published in December 2016 and the latest internal forecasts is considered to be outweighed by the increased transparency and simplicity of this approach.

The resulting supplementary fixed charge will be added to the residential customer tariffs, excluding those applicable to residential customers connected to the DNO via an IDNO as per Ofgem's request. For the avoidance of doubt, the supplementary fixed charge will therefore be applied to the following tariffs:

- Domestic unrestricted;
- Domestic two rate; and
- LV network domestic.

Table 2 presents the supplementary fixed charges which will need to be added to published charges for these customers effective from 1 April 2018, and the impacted tariffs are presented both before (as published in December 2016) and after this adjustment for each licensee in appendix 6. Note that the same methodology will be applied when calculating the necessary change (increase or decrease) in UoS charges effective from 1 April 2019 in respect of the correction of any shortfall or excess revenue recovery in 2018/19. DNOs will publish revised 2019/20 charges to correct for this providing the requisite 40 days' notice as per the DCUSA, which in practical terms will require each DNO to estimate the quantum of the shortfall or surplus at least 40 days prior to the end of the Relevant Regulatory Year.

DNO	LRSP Claim Amount (£m)	Count of Residential Customers (000s)*	Supplementary Fixed Charge (£/year)	Supplementary Fixed Charge (p/day)
ENWL	0.62	2,202	0.29	0.08
NPg (Northeast)	0.42	1,474	0.29	0.08
NPg (Yorkshire)	0.60	2,122	0.29	0.08
SHEPD	0.20	698	0.29	0.08
SEPD	0.79	2,825	0.29	0.08
SP Distribution	0.52	1,849	0.29	0.08
SP Manweb	0.39	1,382	0.29	0.08
UKPN (EPN)	0.94	3,343	0.29	0.08
UKPN (LPN)	0.61	2,077	0.29	0.08
UKPN (SPN)	0.60	2,110	0.29	0.08
WPD (East Midlands)	0.68	2,450	0.29	0.08
WPD (South Wales)	0.29	1,043	0.29	0.08
WPD (South West)	0.42	1,458	0.29	0.08
WPD (West Midlands)	0.64	2,278	0.29	0.08
Total	7.72	27,311		

* Based on forecasts used in published 2018/19 CDCM models, excluding 'Related MPAN' and IDNO tariffs

Table 2 – 2018/19 supplementary fixed charges

Customer impact

As can be seen in Table 2, the impact is minimal on each individual customer with an increase across all DNOs of 0.08 pence per day or £0.29 per annum, with the additional charge consistent for all DNOs due to the dominance of residential customers as a proportion of total customer numbers.

Enduring solution

A long-term solution for future LRSP claims would be to recover the costs as DNOs currently do for e.g. network rates and transmission connection point charges, which, under the RIIO-ED1 price control settlement (and as per previous price controls), are recoverable as pass-through costs. Such costs are recovered with a two-year lag i.e. a DNO's expenditure in 2018/19 would be reflected in its 2020/21 allowed revenue, with a time value of money adjustment in the form of applying the DNO's weighted average cost of capital (WACC) in the intervening periods i.e. 2018/19 and 2019/20 in the example provided.

This would require a change to the electricity distribution licence, in not applying the DNO revenue recovery conditions stipulated in SLC38 (DNOs would still incur the cost in the Relevant Regulatory Year to the SoLR), and amending the special conditions of the electricity distribution licence. Under the current price control settlement, such an amendment would require Charge Restriction Condition 2B 'Calculation of Allowed Pass-Through Items' (hereafter "CRC2B") to include the provision for DNOs to recover costs associated with LRSP claims. This change would also need to incorporate bad debts held by the DNO in respect of outstanding UoS charges owed by the insolvent supplier, for which DNOs currently have no recovery mechanism within the licence but instead act in reliance upon a policy commitment from Ofgem.

This option has been assessed but Ofgem have confirmed it would not be feasible in the timeline associated with CEL's claim.

This option would result in no changes to the requisite notice periods being given and as a result no changes to tariffs which have already been published at the time of a LRSP claim being received by a

DNO. Any shortfall or excess revenue recovery would be corrected through the established over/under-recovery correction mechanism which currently operates, which in RIIO-ED1 does so with a further two year lag, therefore any LRSP correction would continue in perpetuity and both the customer and SoLR would be neutral to the impact, where SLC38 only makes provision for one correction attempt therefore the customer, SoLR or DNO/IDNO carries risk relative to the quantum of the differential between total revenue recovered (both years) and the Specified Amount at the end of the year following the Relevant Regulatory Year.

Further, all customers who arguably benefit from the protection provided by the SoLR process, including those connected to IDNO networks, would contribute to the cost recovery mechanism, however based on the current charging methodologies the majority of the costs would be recovered via volatile volumetric charges. Subject to potential code modifications however, the methodologies could be amended accordingly to allow the specific costs to be allocated directly to specific customer groups if deemed appropriate and/or to a specific charging element (i.e. the fixed charge). This should be considered in parallel with potential licence changes to achieve this enduring solution.

As noted previously, energy suppliers have stated a preference for a consistent DNO approach to the LRSP claim cost recovery, and those that expressed a view on the November 2017 DCUSA Schedule 15 'Cost Information Table' teleconference also noted a preference for this option as a long-term solution. However, it is recognised that in order to achieve this there would need to be a modification to the price control conditions of the licence, and where SLC38 as drafted does not grant Ofgem explicit or implied power to grant the necessary derogations. The DNOs consider that this is the most sensible long-term solution which should be considered further by industry and Ofgem.

Yours sincerely



Lee Wells
Network Revenue Policy Manager (Northern Powergrid)

On behalf of:

1. Electricity North West Limited
2. Northern Powergrid (Northeast) Limited
3. Northern Powergrid (Yorkshire) plc
4. SP Distribution plc
5. SP Manweb plc
6. Scottish Hydro Electric Power Distribution plc
7. Southern Electric Power Distribution plc
8. Eastern Power Networks plc
9. London Power Networks plc
10. South Eastern Power Networks plc
11. Western Power Distribution (East Midlands) plc

12. Western Power Distribution (West Midlands) plc
13. Western Power Distribution (South West) plc
14. Western Power Distribution (South Wales) plc

Appendix 1 – Electricity Distribution Licence SLC 38 – Treatment of payment claims for last-resort supply

Application of this condition

- 38.1 This condition applies if the licensee receives from any Claimant a Valid Claim for a Last Resort Supply Payment.

Obligation to increase Use of System Charges

- 38.2 Where the licensee receives a Valid Claim, it must, during the Relevant Regulatory Year, make an increase to its Use of System Charges relating to the distribution of electricity to premises in respect of that year to such an extent as it reasonably estimates is appropriate to ensure that the consequential increase in its Use of System revenue will equal the Specified Amount.
- 38.3 During, or as soon as practicable after the end of, the Relevant Regulatory Year, the licensee must pay to the Claimant by quarterly or monthly instalments (as specified in the Valid Claim) the amount of the consequential increase in its Use of System revenue mentioned in paragraph 38.2, to the extent that it does not exceed the Specified Amount.

Treatment of any shortfall

- 38.4 If the amount paid to the Claimant under paragraph 38.3 is less than the Specified Amount, the licensee must in the next Regulatory Year:
- a) pay to the Claimant (in accordance with any direction given to the licensee by the Authority) the amount of the shortfall plus 12 months' interest on that amount; and
 - b) increase its Use of System Charges relating to the distribution of electricity to premises during the Regulatory Year that follows the Relevant Regulatory Year to such extent as it reasonably estimates is appropriate to ensure that the consequential increase in its Use of System revenue will equal the amount of the shortfall plus 12 months' interest on that amount.

Treatment of any excess

- 38.5 If the amount of the consequential increase in Use of System revenue mentioned in paragraph 38.3 exceeds the Specified Amount, the licensee must, during the year following the Relevant Regulatory Year, reduce its Use of System Charges relating to the distribution of electricity to premises to the extent that it reasonably estimates is necessary in order to reduce its Use of System revenue for that year by an amount equal to the excess plus 12 months' interest on that amount.

Questions for the Authority

- 38.6 Any question about the reasonableness of any estimate made for the purposes of paragraph 38.2, 38.4, or 38.5 is to be resolved by the Authority.

Disregard of certain matters

- 38.7 In calculating the licensee's Use of System revenue during any period for the purposes of any Charge Restriction Condition that may be applicable to the licensee under this licence, any increase or decrease in Use of System revenue attributable to the licensee's compliance with this standard condition 38 must be treated as if it had not occurred.

38.8 The provisions of this condition have effect even if the licensee has not provided the Notice required under paragraph 17 of standard condition 14 (Charges for Use of System and connection).

Obligation to prepare and publish statement

38.9 The licensee must, in respect of each Regulatory Year in which it increases or reduces its Use of System Charges under paragraph 38.2, 38.4, or 38.5:

- a) prepare a statement that shows the matters detailed at paragraph 38.10;
- b) give any such statement to the Authority within the first four months of the Regulatory Year following that to which it relates; and
- c) publish that statement in such manner as the licensee believes will ensure adequate publicity for it (including on the licensee's Website, if it has one).

38.10 The matters referred to in paragraph 38.9(a) are these:

- a) in the case of an increase in the licensee's Use of System Charges under paragraph 38.2, the total amount of its Use of System revenue derived from that increase;
- b) in the case of an increase in the licensee's Use of System Charges under paragraph 38.4, the total amount of its Use of System revenue derived from that increase;
- c) in the case of a reduction in the licensee's Use of System Charges under paragraph 38.5, the total amount of the decrease in its Use of System revenue resulting from that reduction; and
- d) in the case of each Last Resort Supply Payment made in response to a Valid Claim, the total payments made to the relevant Claimant in respect of the Regulatory Year in question (whenever those payments were made).

Cumulative effect of separate claims

38.11 Where the licensee receives more than one Valid Claim for a Last Resort Supply Payment, such changes in its Use of System Charges as would result from the separate fulfilment of its obligations under this condition in relation to each such claim are to be given effect within the Relevant Regulatory Year as a single aggregated change in Use of System Charges.

Interpretation

38.12 For the purposes of this condition:

Claimant means an Electricity Supplier entitled to receive the benefit of a Last Resort Supply Payment.

Last Resort Supply Payment means a sum of money payable to the Claimant to compensate for any additional costs that it has incurred as a result of complying with a direction from the Authority to supply electricity to premises in accordance with standard condition 8 (Obligations under Last Resort Supply Direction) of the Supply Licence.

Relevant Regulatory Year means, in relation to any Valid Claim:

- a) where the claim was received by the licensee at least 60 days before the beginning of a Regulatory Year, that Regulatory Year; or
- b) where the claim was received by the licensee less than 60 days before the beginning of a Regulatory Year, the next Regulatory Year.

Specified Amount means the amount specified in a Valid Claim plus interest calculated as simple interest on that amount for the period beginning with the date on which the Valid Claim was received by the licensee and ending with the date that is 61 days before the start of the Relevant Regulatory Year (unless that period is of 30 days or less, in which case no interest will be payable).

Valid Claim means a claim for which the Claimant has received the Authority's consent under standard condition 9 (Claims for Last Resort Supply Payment) of the Supply Licence.

Appendix 2 - 10 November 2017 Letter from Northern Powergrid to Ofgem

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DH4 7LA

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Mike Leonard
Senior Manager, Industry Codes and Licensing
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G1 1LH
Mike.Leonard@ofgem.gov.uk

10 November 2017

Dear Mike

Clarification of arrangements under standard condition 38 of the electricity distribution licence

Further to your email of 17 October 2017 in which you outlined Co-operative Energy's claim for a last resort supply payment under standard condition 9 of the electricity supply licence, we are writing to highlight further steps that Ofgem will need to take in order for the process to operate.

Once Ofgem has validated the claim of Co-operative Energy, it will also need to provide:

- consent under clause 19.1B of the distribution connection and use of system agreement (DCUSA) that the periods of notice described in clause 19.1A of the DCUSA need not apply; and
- consent for distribution licensees to charge outside of their charging methodologies in specific areas under paragraph one of standard condition 13 of the electricity distribution licence.

The requisite consents provided by Ofgem should be such that they apply to both the Relevant Regulatory Year (as defined in SLC38) and the year following the Relevant Regulatory Year in the event of any shortfall or excess revenue from the consequential increase in use of system charges as described in SLC38.

Notice period required for a change to use of system charges

We note paragraph eight of SLC38 which references notice periods 'required under paragraph 17 of standard condition 14'. We believe the intent of paragraph eight of SLC38 is to waive the licence requirement of distribution licensees to provide three months' notice of a change to use of system charges, which is found at paragraph 11 of standard condition 14. We would welcome confirmation that our understanding is correct in this regard, and that the reference to paragraph 17 of standard condition 14 in SLC38 is erroneous.

Although SLC38 makes it clear that the notice periods stipulated in the distribution licence do not apply in such cases, this does not alter the obligations as to notice under the DCUSA, so Ofgem will need also to take steps to ensure that by complying with the requirements of SLC38 distribution licensees do not breach the DCUSA (breach of which is also a licence breach). Fortunately the DCUSA makes provision for Ofgem to grant derogations of this kind.

Paragraph two of standard condition 14 requires distribution licensees to set their use of system charges in line with the relevant charging methodology, being the common distribution charging methodology (CDCM)

and extra-high-voltage distribution charging methodology (EDCM), both of which are detailed in the DCUSA. DCUSA Clause 19.1.1 requires distribution licensees to give 15 months' notice of a change to their use of system charges. We note from your email that you consider that 'the 15-month notice period for electricity distribution network charges does not apply to these specific costs'. We would welcome confirmation that concurrent with, or soon after, Ofgem determines that Co-operative Energy has a valid claim, that as per DCUSA Clause 19.1B Ofgem will provide formal consent to distribution licensees to not provide 15 months' notice of a change to use of system charges for the Relevant Regulatory Year and the year following the Relevant Regulatory Year.

Deviation from revenue allowances

DCUSA Schedule 16 clause 54 requires distribution licensees to prepare 'a forecast of allowed revenue for the charging year in accordance with the requirements of the price control conditions'. In order to increase use of system charges as required in paragraph two of SLC38, an adjustment may be required to this forecast as the increase will not be in line with any price control condition. We believe, depending on the adopted methodology for increasing use of system charges, it may be necessary for Ofgem to also grant a derogation to allow distribution licensees to prepare their forecast of allowed revenue for the Relevant Regulatory Year and the year following the Relevant Regulatory Year on the basis of the price control conditions subject to an additional adjustment for revenues relating to the valid claim made in accordance with SLC38.

Methodology for increasing use of system charges

SLC38 does not give details on the methodology by which the necessary increase to use of system charges should be implemented. We would welcome Ofgem's view on how this should be achieved. We believe it would be beneficial to all in the industry (most notably suppliers) if all distribution licensees were to calculate the increase in use of system charges in a consistent manner. We believe Ofgem should also have regard to how the costs associated with any valid claim can be shared across customers in the most equitable manner. There are numerous options for this, for example simply increasing the 'target revenue' in the CDCM; or calculating a 'supplementary' fixed charge for all, or a subset of, customers to be applied either monthly or as a one-off charge. These options all have advantages or disadvantages - for instance fixed charges would be less likely to result in material over-or under-recovery of the specified amount. We would be happy to discuss the detail of this with Ofgem and other licensees to ensure an appropriate approach can be taken.

Please feel free to contact me should you wish to discuss any points raised in this letter in greater detail.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Lee Wells', with a horizontal line underneath.

Lee Wells

Network Revenue Policy Manager

Appendix 3 – Electricity Supply Licence SLC 9 – Claims for Last Resort Supply Payment

Ability to make claim

- 9.1 If the licensee has received the Authority’s consent under paragraph 9.5, it may make a claim for a Last Resort Supply Payment, under standard condition 48 (Last Resort Supply: Payment Claims) of the Distribution Licence, from each Relevant Distributor in whose Distribution Services Area there were premises supplied by the licensee under the Last Resort Supply Direction.
- 9.2 The licensee must not make a claim for a Last Resort Supply Payment if it has waived its ability to do so by Notice given to the Authority before the Authority gave it a Last Resort Supply Direction.

Process for making claim

- 9.3 If the licensee intends to make a claim for a Last Resort Supply Payment, it must:
 - a) give Notice to the Authority of its claim; and
 - b) give the Authority a calculation of the amount claimed with information to support that calculation.
no later than six months after the date on which the Last Resort Supply Direction to which the claim relates stops having effect.
- 9.4 The total amount of the Last Resort Supply Payment (for this condition only, “the relevant amount”) to be claimed by the licensee must not exceed the amount by which:
 - a) the total costs (including interest on working capital) reasonably incurred by the licensee in supplying electricity to premises under the Last Resort Supply Direction and a reasonable profit, are greater than:
 - b) the total amounts recovered by the licensee through Charges for the Supply of Electricity to premises under the Last Resort Supply Direction (after taking all reasonable steps to recover such charges).
- 9.5 If the Authority considers it appropriate in all the circumstances of the case for the licensee to make the claim notified to it in accordance with paragraph 9.3, the Authority will give its consent to the licensee.
- 9.6 Within three months after it has been notified of the claim in accordance with paragraph 9.3, the Authority may determine that an amount other than the one calculated by the licensee is a more accurate calculation of the relevant amount.
- 9.7 If the Authority makes a determination under paragraph 9.6, the amount specified by it must be treated as the relevant amount for the purpose of paragraph 9.8.

Submissions to Relevant Distributors

- 9.8 A claim by the licensee for a Last Resort Supply Payment from each Relevant Distributor referred to in paragraph 9.1 must specify:
 - a) the respective proportion of the relevant amount to be paid by that Relevant Distributor (being the same as the number of premises located within its Distribution Services Area when expressed as a proportion of the total number of premises located within the Distribution Services Areas of all the Relevant Distributors in question); and
 - b) whether payment is to be made by quarterly or monthly instalments.
- 9.9 A claim for a Last Resort Supply Payment will lapse if the licensee does not make it within six months after the Authority has given its consent under paragraph 9.5.

Appendix 4 - Options for the Recovery of a Claim for a Last Resort Supply Payment

Please note that this working paper was drafted and reviewed by all DNOs in advance of CEL submitting its claim, in order to assess the various options against the criteria. Therefore any quantitative assessment does not necessarily align to that in this letter.

1. Introduction

- 1.1 The purpose of this document is to detail the options available to distribution network operators (DNOs) for the recovery of a claim for a Last Resort Supply Payment (LRSP). Such a claim is expected to be received from Co-operative Energy Limited (CEL) in January 2018 following its appointment as the Supplier of Last Resort (SoLR) for GB Energy Supply Limited (GBES) in November 2016.
- 1.2 Various Standard Licence Conditions (SLCs) in both the distribution and supply licences govern the recovery of a claim from customers through an increase to Use of System (UoS) charges. This paper summarises the position, and makes a proposal for a common approach for DNOs to apply when determining an increase to their UoS charges.

2. Background

- 2.1 On 29 November 2016, Ofgem appointed CEL as the SoLR for GBES' gas and electricity customers following GBES' failure. At the time of failure, GBES held credit balances in respect of a number of its customers, which were transferred to CEL.
- 2.2 CEL has since indicated its intention to make a claim for around 70% of the credit balances which were transferred to it as part of its appointment as the SoLR. In response, on 16 November 2017, Ofgem published a 'minded to' decision¹, outlining that it is minded to consent to CEL claiming a LRSP of up to £14.04m.
- 2.3 Under SLC9 of the electricity supply licence (see appendix 3), CEL may make a claim from each distribution licensee which distributed either gas or electricity to customers GBES supplied at the time of failure. The total LRSP will be split between the relevant distributors (i.e. those who had premises supplied by GBES connected to their networks at the time of failure) in proportion of their combined total customer numbers.
- 2.4 It is not yet clear how the total claim for a LRSP will be split between electricity and gas distribution licensees; however Ofgem have indicated that a 50/50 split or an apportionment based on GBES' customer numbers at the time of failure would result in a similar outcome. They have also advised that they intend to refer to the split of the claim between gas and electricity networks in their decision letter, in addition to the data sources they consider reasonable for CEL to use to determine the distribution of premises across distribution areas. Hence, for the purposes of this paper, it will be assumed that electricity distribution licensees will collectively receive claims for a LRSP of £7.02m.
- 2.5 Ofgem has indicated that it is looking into how Independent Distribution Network Operators (IDNOs) should be treated in regard to a claim for a LRSP from CEL. The working assumption for this paper is that IDNOs are not liable for a claim from CEL.

¹ https://www.ofgem.gov.uk/system/files/docs/2017/11/last_resort_supplier_payment_claim_from_co-operative_energy_002.pdf

- 2.6 Under SLC38 of the electricity distribution licence (see appendix 1), a distributor receiving a claim for a LRSP must increase its UoS charges in the following regulatory year (if the claim is received more than 60 days before the start of the regulatory year) or the year after (if the claim is received less than 60 days before the start of the regulatory year) to recover the amount of the claim plus interest. In practical terms, this will mean that if a DNO receives a claim before 31 January 2018, it must increase its UoS charges in 2018/19 - Ofgem intend to publish their decision to enable CEL to make their claim prior to this date. The DNO must then in due course calculate the revenue it has derived from the increase to its 2018/19 charges, and determine whether there is a shortfall/surplus to the revenue targeted. Any such shortfall/surplus must be corrected by a change to its UoS charges for the following year (2019/20 in the example given previously).
- 2.7 In reality, this will require the DNO to forecast any shortfall/surplus part way through the first year in which it has amended its tariffs, in order to determine the amendment to tariffs needed in the second year before the start of the second year. SLC38 provides no means for any outstanding shortfall/surplus remaining at the end of the second year to be corrected.
- 2.8 SLC38 of the electricity distribution licence does not specify any methodology by which an increase to UoS charges should be calculated and applied.
- 2.9 SLC14 of the electricity distribution licence requires a distributor to give three months' notice of a change to its UoS charges. This requirement is referred to in SLC38, which states that the requirements of SLC38 apply even if this results in the distributor not complying with the notice periods required under SLC14. It is presumed that this is intended to ensure that the requirements of SLC38 take precedence over the notice periods referred to in SLC14 but it will be noted that it does not explicitly disapply these.
- 2.10 In addition, under the Distribution Connection and Use of System Agreement (DCUSA), a distributor is required to give 15 months' notice of a change to its UoS charges. This is a contractual requirement that applies in addition to any licence obligations. In accordance with this requirement, UoS charges for 2018/19 were published in December 2016.
- 2.11 As a result of the requirement to give 15 months' notice of a change to UoS charges, even if the claim for a LRSP is not received until after 31 January 2018 (and so an increase to UoS charges not required until 2019/20), 2019/20 UoS charges will have been published in December 2017 and so a change will be required to charges which have been published.
- 2.12 Ofgem has indicated in correspondence with distributors that it is aware that it will be required to give consents and/or derogations for certain requirements, which is presumed to include the DCUSA requirement to give 15 months' notice. Northern Powergrid brought this matter to Ofgem's attention in a letter dated 10 November 2017 (see appendix2).

3. Options for the Recovery of a LRSP by DNOs

- 3.1 It has been acknowledged by the industry (most notably at the Distribution Charging Methodologies Development Group (DCMDG)) that it would be favourable for DNOs to take a common approach to calculating the necessary increase to their UoS charges. This point has also been made to Ofgem, and several Parties have suggested an Ofgem coordinated industry meeting would be an ideal means of ensuring a common approach can be agreed. Ofgem has indicated that it is 'willing to comment on any proposal' but made clear that it expects the industry to provide such a proposal without its involvement.

- 3.2 Three options (and one additional sub-option) have been considered for calculating the increase to UoS charges required to allow DNOs to recover a LRSP claim. The options range from a position which would require changes to all published UoS charges or where only those of a subset of customers change, namely residential (with the sub-option being the change is only applied to the unrestricted customers within this group).
- 3.3 Options which would require a change to non-domestic customers but not all customers were discounted. Consideration was given to the intent to provide an equitable but simple, transparent and predictable solution, which would (specifically in the context of undermining the 15 months' notice period otherwise provided) represent an option which introduced minimal disturbance to stakeholders.
- 3.4 Having considered the representation of residential customers in those supplied by GBES at the time of failure (>99%) and the dominance of these customers in respect of total DNO customers, further in consideration that those customers arguably receive the greatest protection from the SoLR process, it was considered that the scope of any option not utilising existing charging methodologies should be limited to residential customers.
- 3.5 This has been supported by stakeholder engagement which has highlighted both the need for DNOs to proceed on a common basis and also a preference to avoid a need to change published charges for all customers.
- 3.6 Depending on the option, for example a supplementary fixed charge, and due to the dominance of residential customers in proportion to the DNO customer base, the resulting impact on residential charges by socialising these costs across all customer groups is negligible.
- 3.7 The options are discussed in more detail below.

Option 1 – Calculate an increase to the UoS payable by a customer in each customer group.

- 3.8 The only practicable manner in which this can be achieved is believed to be by using the published Common Distribution Charging Methodology (CDCM) model for the relevant regulatory year, increase the 'Total Revenue for Use of System Charges' by the amount of the intended increase.
- 3.9 Any other method would involve the derivation of a new methodology by which the targeted amount should be split between customer groups. Under the timescales available, the definition of a new methodology by which an increase to charges for all customers could be appropriately calculated so as to recover an equitable proportion of the targeted amount from each customer group is unachievable and so has been discounted.

Advantages	Disadvantages
<ul style="list-style-type: none"> • Uses the charging methodology defined within the CDCM for calculating updated UoS tariffs to recover the DNOs allowed revenue alongside the required increase to UoS charges for the LRSP; hence commonality across different licensees would be easily achieved without the need to define a new methodology by which the increase in charges should be calculated. • Although it would be challenging for DNOs to complete the calculations and preparation of documentation with sufficiently robust controls carried out, this could be implemented in a timely manner, with the minimum 60 day notice period 	<ul style="list-style-type: none"> • Would result in every tariff calculated in the CDCM changing, causing significant disturbance to DNOs' invoicing processes (e.g. billing and revenue forecasting systems to be updated) and to suppliers' validation processes. • The increase to UoS charges would be recovered entirely through unit rates, as the change in target revenues would impact the 'scaling' element of the CDCM only (either by increasing positive scaling in licensees where the underlying CDCM results in a revenue shortfall or by decreasing negative scaling in licensees where the underlying CDCM results in a revenue surplus). This has several disadvantages in

Advantages	Disadvantages
<p>afforded to DNOs expected to be sufficient to enable charges to be recalculated and the requisite documentation prepared.</p> <ul style="list-style-type: none"> All customers benefit from the protection provided by the SoLR process, and therefore an equitable cost allocation would arguably cover all customers. 	<p>itself:</p> <ul style="list-style-type: none"> The increase in unit rates would effectively manifest as a stronger cost signal on customers to reduce overall consumption. This would be logical if the cost to the DNO of making a payment to CEL in respect of a claim for a LRSP could be reduced by customers reducing consumption. This is clearly not the case, as the amount of the claim is fixed at the point when the claim is made. SLC38 of the electricity distribution licence requires that any shortfall/surplus in the amount a distributor recovers from the increase to its UoS charges must be corrected by an increase/decrease to UoS charges in the following regulatory year. By recovering the additional revenue entirely on unit rates, the shortfall/surplus is likely to be significant, as it will be dependent on actual units distributed which varies on a number of factors (most notably weather); hence the correction in the following year will also be significant, resulting in the first disadvantage being repeated in two consecutive years. Add to this that the revenue generated from the increase to UoS charges would not be fully determined until the reconciliation processes in settlement reach completion 14 months after the consumption date (i.e. 31 May 2020 for consumption on 31 March 2019), so a distributor will be unable to determine the exact amount it has recovered from the increase until well into the future, resulting in the process of recovering amounts for a LRSP dragging out well into the future, with the potential for a significant imbalance to remain at the end of the second year with no correction mechanism (as detailed in paragraph 2.7). By amending its forecast of revenue allowances in its CDCM model to include an amount in respect of a claim for a LRSP, a DNO would not be preparing 'a forecast of allowed revenue for the charging year in accordance with the requirements of the price control conditions' as required by the CDCM; hence a derogation would be required from Ofgem from certain DCUSA conditions. In applying the increase to CDCM customers only, designated extra-high voltage (EHV) customers who have tariffs calculated in the EHV Distribution Charging Methodology (EDCM) would effectively be exempted, and so not all customers would be contributing, undermining the third cited advantage. If this were to be amended to include EDCM customers also the second cited advantage of 'implementability' would be undermined, as changing tariffs for both CDCM and EDCM customers would be very difficult to achieve in the timescales available. In respect of CEL's claim, 70% of the proposed value relates to the recovery of the credit balances, of which >99% relates to domestic customers (see appendix 5). Arguably an equitable cost recovery

Advantages	Disadvantages
	<p>solution could therefore be to recover these costs from domestic customers only, whereby:</p> <ul style="list-style-type: none"> - Larger (e.g. industrial) customers are far less likely to be in a situation where they hold credit balances with energy suppliers due to potential pass-through arrangements and general size of their energy bill. Is it therefore fair that these customers should have to cross subsidise domestic customers in respect of these costs? - It is also possible that due to longer-term contractual arrangements with bigger customers, that the supplier may need to recover the costs from smaller users regardless of which customers the DNO's increase to UoS charges is notionally applied. Suppliers are not obliged to pass on the DNO cost signals, nor reflect proportionally the difference in cost between different types of customers (relative to whom they supply) of the different charging elements i.e. fixed or volumetric charges.

Option 2a – calculate a supplementary fixed charge for all residential customers.

Advantages	Disadvantages
<ul style="list-style-type: none"> • This option has the benefit of simplicity and predictability, as a fixed charge can be easily calculated based on the target revenue to be recovered and the count of customers. • At the time of failure, the majority (99.4%) of GBES' customers were residential (see appendix 5). Hence this option would split the cost of settling the credit balances of predominantly residential customers between other residential customers. In this way, it could be argued that the aim of the SoLR process has been achieved, in that residential customers are afforded collective security through the risk of supplier failure being spread across all residential customers. • In seeking to recover costs driven by and from residential customers this prevents other (e.g. industrial and commercial) customers from cross-subsidising residential customers, especially when bigger customers are less likely to hold credit balances with energy suppliers, and so are less likely to benefit from the SoLR process at any time. • The majority of tariffs would remain unchanged, making this option easy to implement, track and report on. • Customer counts do vary throughout each year but not to the same extent as units distributed; hence any shortfall/surplus derived from an increase to charges should be small, resulting in a minor correction in the second year and a final position shortly after the end of the second year which would be expected to be very close to the targeted amount. • This could be implemented in a timely manner, with the minimum 60 day notice period afforded to DNOs expected to provide ample time for the supplementary fixed charge to be calculated and the requisite documentation prepared. 	<ul style="list-style-type: none"> • There is no published methodology by which such a fixed charge should be calculated. Whilst such a methodology would be straightforward to develop, careful drafting would be required to ensure transparency and commonality across the industry. • In determining such a supplementary fixed charge, a DNO would not be complying with its published charging methodology (effectively the CDCM and EDCM), and so would require derogation from SLC14. • All customers benefit from the protection provided by the SoLR process, and therefore an equitable cost allocation would arguably be to recover the costs from all customers regardless of whether a particular group is driving the costs associated with a particular claim.

Option 2b – calculate a supplementary fixed charge for all domestic unrestricted customers only.

Advantages	Disadvantages
<ul style="list-style-type: none"> • This option has the benefit of simplicity and predictability, as a fixed charge can be easily calculated based on the target revenue to be recovered and the count of customers. • At the time of failure, the majority (93.9%) of GBES' customers were residential and specifically domestic unrestricted (see appendix 5). Hence this option would split the cost of settling the credit balances of predominantly domestic unrestricted customers amongst that customer group only. • In seeking to recover costs driven by and from residential, predominantly domestic unrestricted, customers this prevents other (e.g. industrial and commercial customers) from cross-subsidising residential customers, especially when bigger customers are less likely to hold credit balances with energy suppliers, and so less likely to ever benefit from the SoLR process. • The majority of tariffs would remain unchanged, making this option easy to implement. • Customer counts do vary throughout each year but not to the same extent as units distributed; hence any shortfall/surplus derived from an increase to charges should be small, resulting in a minor correction in the second year and a final position shortly after the end of the second year which would be expected to be very close to the targeted amount. • This could be implemented in a timely manner, with the minimum 60 day notice period afforded to DNOs expected to provide ample time for the supplementary fixed charge to be calculated and the requisite documentation prepared. 	<ul style="list-style-type: none"> • There is no published methodology by which such a fixed charge should be calculated. Whilst such a methodology would be straightforward to develop, careful drafting would be required to ensure transparency and commonality across the industry. • In determining such a supplementary fixed charge, a DNO would not be complying with its published charging methodology (effectively the CDCM and EDCM), and so would require derogation from SLC14. • All customers benefit from the protection provided by the SoLR process, and therefore an equitable cost allocation would arguably be to recover the costs from all customers regardless of whether a particular group is driving the costs associated with a particular claim. • Other residential customers (i.e. two rate and LV network domestic customers) will not be contributing to the recovery of the costs for the protection they have been given by CEL as the SoLR. This is of particular concern for the LV network domestic customers, with this tariff intended to mirror the domestic unrestricted tariff but on a three-rate rather than single rate tariff structure, to avoid a step change in tariff when a customer moves to half-hourly settlement. By increasing tariffs for domestic unrestricted customers only, a step change between this and the LV network domestic tariff will be created, and customers moving to half-hourly settlement will be exempted from contributing to the LRSP.

Option 3 – seek derogation from Ofgem to not apply the DNO revenue recovery conditions of SLC38, and instead treat the additional revenue required as an 'allowance' in the year in question.

Advantages	Disadvantages
<ul style="list-style-type: none"> • Results in no changes to charges without the requisite notice periods being given (i.e. 15 months' notice as per the DCUSA), and as a consequence no changes to tariffs which have already been published. The additional allowance in the relevant year would (all other things being equal) generate an under-recovery position, which would be corrected through the established processes under the Charge Restriction Conditions (CRCs) of the distribution licence. • There would be no shortfall/surplus in the revenue generated from increases to UoS charges from this option. The correction mechanism in SLC38 only applies for a single year (as detailed in paragraph 2.7) whereas the under/over recovery correction mechanisms of the CRCs effectively apply indefinitely, ensuring that exactly the targeted revenue is recovered in the long term. • All customers benefit from the protection provided 	<ul style="list-style-type: none"> • Some licence conditions contain within them the power for Ofgem to issue a derogation. This power can be explicit or it can be implicit in words such as 'except with the consent of the Authority the licensee must....' SLC38 however, contains neither an explicit nor an implied power for Ofgem to grant derogations from the obligations set out in the condition. The absence of such a power means that, strictly speaking, Ofgem <i>must</i> enforce the obligations of SLC38 unless it can find a reason not to take enforcement action. Such a reason must satisfy section 25 of the Electricity Act 1989. Although Ofgem might well conclude that it need take no enforcement action because an alternative approach was being followed, the absence of any express or implied power to grant a derogation adds a procedural complication that makes this option less straightforward. • As with option 1, the change to UoS charges caused

Advantages	Disadvantages
<p>by the SoLR process, and therefore an equitable cost allocation would arguably cover all customers.</p> <ul style="list-style-type: none"> • Represents a more long-term enduring solution which would provide consistency and clarity to all parties in the event of future LRSP claims. 	<p>by a change to allowances in this manner (i.e. the difference between UoS charges calculated on this basis and those which would have been calculated had this adjustment to allowances not been made) would be entirely on unit rates (as it would impact the 'scaling' element of the CDCM). Hence, the disadvantage of option 1 regarding the increased cost signal which would be generated by this adjustment would also exist under this option.</p> <ul style="list-style-type: none"> • To complete this option there would need to be a modification of the price control conditions of the distribution licence. The drafting of such a modification would be complex, and is expected to be unachievable in the timescales available. Consequently (assuming a claim is received before 31 January 2018), DNOs would need an agreement with Ofgem to not increase UoS charges in line with SLC38 in 2018/19 and to continue discussions into the future on how the licence could be modified. Such a modification would need to follow the process by which licence modifications are made and that process is one over which third parties enjoy appeal rights. Therefore, it cannot be assumed that the modifications that would allow the distributor to recover the money under its price control would be implemented in the way that Ofgem and the distributors had agreed.

4. Recommended Option

- 4.1 Whilst the advantages of option 3 are significant, and it is arguably in principle the best long-term solution to the problem presented, the major disadvantages of the uncertainty over whether Ofgem has the power to grant the required derogations, and of the timeliness of implementation (which Ofgem have confirmed would not be feasible in respect of this specific CEL claim) and consequent uncertainty over whether the DNO could recover the revenue in the long term is considered to render this option unfeasible. Options 2a and 2b have the benefit of simplicity, ease of implementation and lower administration requirements, whilst arguably option 2a better implements the aims of the SoLR process.
- 4.2 The DNOs provided an update on CEL's LRSP claim and the various options to energy suppliers via the November DCUSA Schedule 15 'Cost Information Table' teleconference, with the clear message from suppliers being the need for a consistent DNO cost recovery approach. Suppliers commented that they would be keen to establish the enduring solution via a change to the licence but were understanding in the complexities involved and need to get it right, which as Ofgem have outlined in communication with the DNOs is not a feasible option for the expected timeline of this claim. Suppliers were receptive to the alternative option of a supplementary fixed charge applied to residential customers.
- 4.3 DNOs have commonly agreed that, in this instance, the CEL claim costs should be recovered via a supplementary fixed charge, with the majority in favour of option 2a as opposed to option 2b, where at the time of failure the majority (99.4% - see appendix 5) of GBES customers were residential. This approach has the benefit of increased simplicity and predictability, and unlike option 2b does not sacrifice some cost-reflectivity where not all residential customers (i.e. two rate and LV network domestic) would be contributing to the recovery of costs for which they

benefitted from the protection for. This consideration applies to other customer groups, but to a much lesser extent.

- 4.4 Hence, with Ofgem’s agreement, option 2a is the proposed option that should be used in respect of this specific CEL LRSP claim.
- 4.5 Option 3 should be progressed as a long-term enduring solution in a timely manner which would preferably be applied in any future claims.

5. Detail of the Selected Option

- 5.1 Assuming that the total LRSP claim made by CEL to electricity distribution licensees is £7.02m (as per paragraph 2.4), and that GBES supplied customers in all 14 DNO areas, the claims made to each licensee may be broadly as shown in Table 1. Note that clause 8 of SLC9 of the supply licence results in the total LRSP amount being split between all distributors which had customers supplied by GBES within their distribution area at the time of failure in proportion to the total number of premises within those distribution areas, regardless of the proportion of GBES’ customers in each distribution area.

Distribution Licensee	Total Number of Premises (000s)*	Proportion of Total Number of Premises	Illustrative LRSP Claim Amount (£m)
ENWL	2,443	8.1%	0.57
NPg (Northeast)	1,648	5.4%	0.38
NPg (Yorkshire)	2,334	7.7%	0.54
SHEPD	777	2.6%	0.18
SEPD	3,117	10.3%	0.72
SP Distribution	2,050	6.8%	0.47
SP Manweb	1,518	5.0%	0.35
UKPN (EPN)	3,692	12.2%	0.85
UKPN (LPN)	2,409	7.9%	0.56
UKPN (SPN)	2,331	7.7%	0.54
WPD (East Midlands)	2,721	9.0%	0.63
WPD (South Wales)	1,138	3.8%	0.26
WPD (South West)	1,635	5.4%	0.38
WPD (West Midlands)	2,528	8.3%	0.58
Total	30,340		7.02

* Based on forecasts used in published 2018/19 CDCM models, excluding 'Related MPAN' and UMS tariffs

Table 1 – Illustrative breakdown of total LRSP by distribution licensee

- 5.2 Each DNO will then need to calculate a supplementary fixed charge to be added to the fixed charges of its residential customers. The most transparent way to do so would be to take the forecast of customer numbers in the published 2018/19 CDCM model as the customer count over which to recover the target amount (i.e. to sum the highlighted cells in Table 2 below), which is an extract of table 1053 (volume forecasts for the charging year) from the 2018/19 CDCM model:

	Rate 1 units (MWh)	Rate 2 units (MWh)	Rate 3 units (MWh)	MPANs
> Domestic Unrestricted				
Domestic Unrestricted	4,419,076.334			1,390,259
LDNO LV: Domestic Unrestricted	78,223.095			27,030
LDNO HV: Domestic Unrestricted	82,398.926			28,157
> Domestic Two Rate				
Domestic Two Rate	223,253.607	231,808.925		84,206
LDNO LV: Domestic Two Rate	108.970	51.875		50
LDNO HV: Domestic Two Rate	1,965.263	5,906.354		1,498
> Domestic Off Peak (related MPAN)				
Domestic Off Peak (related MPAN)	63,655.183			14,395
LDNO LV: Domestic Off Peak (related MPAN)				
LDNO HV: Domestic Off Peak (related MPAN)				
> Small Non Domestic Unrestricted				
Small Non Domestic Unrestricted	864,711.988			76,224
LDNO LV: Small Non Domestic Unrestricted	2,142.130			250
LDNO HV: Small Non Domestic Unrestricted	4,353.755			259
> Small Non Domestic Two Rate				
Small Non Domestic Two Rate	225,633.608	127,839.615		17,153
LDNO LV: Small Non Domestic Two Rate	23.357	11.037		
LDNO HV: Small Non Domestic Two Rate	662.437	459.970		29
> Small Non Domestic Off Peak (related MPAN)				
Small Non Domestic Off Peak (related MPAN)	5,993.198			486
LDNO LV: Small Non Domestic Off Peak (related MPAN)				
LDNO HV: Small Non Domestic Off Peak (related MPAN)				
> LV Medium Non-Domestic				
LV Medium Non-Domestic	0.001	0.000		0
LDNO LV: LV Medium Non-Domestic				
LDNO HV: LV Medium Non-Domestic				
> LV Sub Medium Non-Domestic				
LV Sub Medium Non-Domestic	0.001	0.000		0
> HV Medium Non-Domestic				
HV Medium Non-Domestic	0.001	0.000		0
> LV Network Domestic				
LV Network Domestic				
LDNO LV: LV Network Domestic				
LDNO HV: LV Network Domestic				
> LV Network Non-Domestic Non-CT				
LV Network Non-Domestic Non-CT	107,689.800	262,204.601	264,213.206	9,933
LDNO LV: LV Network Non-Domestic Non-CT				
LDNO HV: LV Network Non-Domestic Non-CT	108.180	366.918	501.038	2
> LV HH Metered				
LV HH Metered	261,735.081	878,557.574	1,039,588.645	10,610
LDNO LV: LV HH Metered	1,210.540	3,499.812	4,990.957	50
LDNO HV: LV HH Metered	9,524.710	28,951.874	38,648.889	246
> LV Sub HH Metered				
LV Sub HH Metered	48,055.189	159,449.141	222,997.396	561
LDNO HV: LV Sub HH Metered	288.020	1,203.394	885.982	5
> HV HH Metered				
HV HH Metered	321,279.775	1,005,990.608	1,453,904.553	896
LDNO HV: HV HH Metered	6,191.591	19,818.986	26,972.433	26
> NHH UMS category A				
NHH UMS category A	18,698.955			637
LDNO LV: NHH UMS category A	830.844			205
LDNO HV: NHH UMS category A	1,278.214			103
> NHH UMS category B				
NHH UMS category B	106,080.237			413
LDNO LV: NHH UMS category B	14.907			3
LDNO HV: NHH UMS category B	93.540			
> NHH UMS category C				
NHH UMS category C	810.253			39
LDNO LV: NHH UMS category C				
LDNO HV: NHH UMS category C				
> NHH UMS category D				
NHH UMS category D	1,185.680			22
LDNO LV: NHH UMS category D				
LDNO HV: NHH UMS category D				
> LV UMS (Pseudo HH Metered)				
LV UMS (Pseudo HH Metered)	3,499.583	10,707.443	45,556.871	11
LDNO LV: LV UMS (Pseudo HH Metered)				
LDNO HV: LV UMS (Pseudo HH Metered)				

Table 2 - Calculation of customer count for supplementary fixed charge calculation

5.3 This forecast customer count was made in December 2016 (when 2018/19 charges were published) and so is not the latest view available. It would be possible to achieve a more accurate forecast by the DNO using its latest forecast of customer numbers for 2018/19, but this would result in each DNO producing a new forecast, and a corresponding loss of transparency and simplicity. Customer counts (particularly residential customer counts) are not volatile, with steady growth expected in most regions. Hence, the slight loss of accuracy caused by the variance between the forecast for 2018/19 published in December 2016 and the latest forecast for 2018/19 is considered to be outweighed by the increased transparency and simplicity of this approach.

5.4 The resulting supplementary fixed charge would be added to the tariffs to which each of the highlighted cells relates (i.e. the all-the-way and IDNO domestic unrestricted tariffs). It is expected that an IDNO will increase its UoS tariffs by the same supplementary fixed charge, thus leaving the IDNO margin unaltered whilst ensuring that customers connected to that IDNO's networks contribute to the recovery of the LRSP alongside customers connected to DNO networks. Table 3 gives an illustration of how the supplementary fixed charge would be calculated.

Distribution Licensee	LRSP Claim Amount (£m)	Count of Residential Customers (000s)*	Supplementary Fixed Charge (£/year)	Supplementary Fixed Charge (p/day)
ENWL	0.57	2,263	0.25	0.07
NPg (Northeast)	0.38	1,531	0.25	0.07
NPg (Yorkshire)	0.54	2,176	0.25	0.07
SHEPD	0.18	703	0.26	0.07
SEPD	0.72	2,862	0.25	0.07
SP Distribution	0.47	1,911	0.25	0.07
SP Manweb	0.35	1,407	0.25	0.07
UKPN (EPN)	0.85	3,408	0.25	0.07
UKPN (LPN)	0.56	2,124	0.26	0.07
UKPN (SPN)	0.54	2,142	0.25	0.07
WPD (East Midlands)	0.63	2,517	0.25	0.07
WPD (South Wales)	0.26	1,051	0.25	0.07
WPD (South West)	0.38	1,477	0.26	0.07
WPD (West Midlands)	0.58	2,326	0.25	0.07
Total	7.02	27,898		

* Based on forecasts used in published 2018/19 CDCM models, excluding 'Related MPAN' tariffs

Table 3 - Illustrative calculation of supplementary fixed charge

- 5.5 Given the latest a claim can be received is 60 days prior to the start of the regulatory year in which the distributor must increase its UoS charges, distributors will provide no less than 40 days' notice (as required under DCUSA clause 19.1B) of the final supplementary fixed charge which will be applied.
- 5.6 As the supplementary fixed charge is calculated on the basis of a forecast of customer numbers but will be applied to actual customer numbers, it is inevitable that there will be a shortfall/surplus in the revenue derived from the supplementary charge against the amount targeted. Hence, the distributor will be required to apply a supplementary fixed charge in the following year. Distributors will again give no less than 40 days' notice of the final supplementary fixed charge which will be applied. In reality, this will require distributors to forecast the shortfall/surplus in revenue derived based on actual customer numbers (from initial reconciliations (SF)) up to and including December of the first year and a forecast for the remainder.
- 5.7 Fixed charges are rounded to two decimal places of a penny. As a result, the threshold of error at which the correctional supplementary fixed charge in the second year will be non-zero is relatively high, with an error tolerance of circa $\pm 7\%$ on customer counts in the first year for a non-zero supplementary fixed charge to be required in the second year.
- 5.8 The disadvantage of this relatively high error tolerance is that there is the potential for the amount recovered to differ from the amount targeted simply due to rounding. In a worst case scenario where the end position for every distributor is that their correctional fixed charge in the second year would be 0.00499 p/day, and so round to zero, the total error in the amount recovered from customers would be around £0.5m. However, it is highly unlikely that this total

will be reached, with some distributors likely to finish with a surplus due to the rounding error, and others a shortfall.

Appendix 5 – Total DNO customers supplied by GBES at the time of failure

Customer Group	GB Energy Total Customer Count at Time of Default	Proportion of GB Energy Customer Count at Time of Default	2018/19 Total GB Customer Count	Proportion of 2018/19 GB Customer Count
Domestic Unrestricted	140,325	93.9%	23,559,748	76.5%
Domestic Two Rate	8,004	5.4%	3,919,719	12.7%
Domestic Off Peak (related MPAN)	195	0.1%	409,846	1.3%
Small Non Domestic Unrestricted	777	0.5%	1,640,426	5.3%
Small Non Domestic Two Rate	119	0.1%	474,146	1.5%
Small Non Domestic Off Peak (related MPAN)	9	0.0%	33,250	0.1%
LV Medium Non-Domestic	2	0.0%	2,332	0.0%
LV Sub Medium Non-Domestic	-	-%	37	0.0%
HV Medium Non-Domestic	-	-%	27	0.0%
LV Network Domestic	5	0.0%	418,056	1.4%
LV Network Non-Domestic Non-CT	-	-%	111,798	0.4%
LV HH Metered	-	-%	166,748	0.5%
LV Sub HH Metered	-	-%	10,870	0.0%
HV HH Metered	-	-%	22,764	0.1%
NHH UMS category A	-	-%	15,047	0.0%
NHH UMS category B	-	-%	11,588	0.0%
NHH UMS category C	-	-%	2,469	0.0%
NHH UMS category D	-	-%	444	0.0%
LV UMS (Pseudo HH Metered)	-	-%	375	0.0%
Total	149,436	100.0%	30,799,686	100.0%

Appendix 6 – 2018/19 UoS charges before and after CEL LRSP claim adjustment

Published 2018/19 UoS charges					Supplementary	Revised fixed
Electricity North West Limited	Unit rate 1	Unit rate 2	Unit rate 3	Fixed charge	fixed charge	charge
	p/kWh	p/kWh	p/kWh	p/MPAN/day	p/MPAN/day	p/MPAN/day
Domestic Unrestricted	2.205			3.23	0.08	3.31
Domestic Two Rate	2.536	0.686		3.23	0.08	3.31
LV Network Domestic	9.803	1.855	0.668	3.23	0.08	3.31

Published 2018/19 UoS charges					Supplementary	Revised fixed
Northern Powergrid (Northeast) Limited	Unit rate 1	Unit rate 2	Unit rate 3	Fixed charge	fixed charge	charge
	p/kWh	p/kWh	p/kWh	p/MPAN/day	p/MPAN/day	p/MPAN/day
Domestic Unrestricted	2.202			5.30	0.08	5.38
Domestic Two Rate	2.526	0.968		5.30	0.08	5.38
LV Network Domestic	7.287	1.817	0.955	5.30	0.08	5.38

Published 2018/19 UoS charges					Supplementary	Revised fixed
Northern Powergrid (Yorkshire) plc	Unit rate 1	Unit rate 2	Unit rate 3	Fixed charge	fixed charge	charge
	p/kWh	p/kWh	p/kWh	p/MPAN/day	p/MPAN/day	p/MPAN/day
Domestic Unrestricted	1.805			5.10	0.08	5.18
Domestic Two Rate	2.019	1.054		5.10	0.08	5.18
LV Network Domestic	4.660	1.701	1.031	5.10	0.08	5.18

Published 2018/19 UoS charges					Supplementary	Revised fixed
SP Distribution plc	Unit rate 1	Unit rate 2	Unit rate 3	Fixed charge	fixed charge	charge
	p/kWh	p/kWh	p/kWh	p/MPAN/day	p/MPAN/day	p/MPAN/day
Domestic Unrestricted	2.416			5.02	0.08	5.10
Domestic Two Rate	2.854	1.117		5.02	0.08	5.10
LV Network Domestic	8.906	1.856	1.056	5.02	0.08	5.10

Published 2018/19 UoS charges					Supplementary	Revised fixed
SP Manweb plc	Unit rate 1	Unit rate 2	Unit rate 3	Fixed charge	fixed charge	charge
	p/kWh	p/kWh	p/kWh	p/MPAN/day	p/MPAN/day	p/MPAN/day
Domestic Unrestricted	2.844			3.61	0.08	3.69
Domestic Two Rate	3.305	1.158		3.61	0.08	3.69
LV Network Domestic	11.815	1.989	1.063	3.61	0.08	3.69

Published 2018/19 UoS charges					Supplementary	Revised fixed
Scottish Hyrdro Electric Power Distribution plc	Unit rate 1	Unit rate 2	Unit rate 3	Fixed charge	fixed charge	charge
	p/kWh	p/kWh	p/kWh	p/MPAN/day	p/MPAN/day	p/MPAN/day
Domestic Unrestricted	3.132			7.94	0.08	8.02
Domestic Two Rate	3.485	1.878		7.94	0.08	8.02
LV Network Domestic	7.640	3.042	1.598	7.94	0.08	8.02

Published 2018/19 UoS charges					Supplementary	Revised fixed
Southern Electric Power Distribution plc	Unit rate 1	Unit rate 2	Unit rate 3	Fixed charge	fixed charge	charge
	p/kWh	p/kWh	p/kWh	p/MPAN/day	p/MPAN/day	p/MPAN/day
Domestic Unrestricted	2.102			2.88	0.08	2.96
Domestic Two Rate	2.357	0.766		2.88	0.08	2.96
LV Network Domestic	8.116	1.413	0.728	2.88	0.08	2.96

Published 2018/19 UoS charges					Supplementary fixed charge p/MPAN/day	Revised fixed charge p/MPAN/day
	Unit rate 1 p/kWh	Unit rate 2 p/kWh	Unit rate 3 p/kWh	Fixed charge p/MPAN/day		
Eastern Power Networks plc						
Domestic Unrestricted	1.991			4.35	0.08	4.43
Domestic Two Rate	2.421	0.157		4.35	0.08	4.43
LV Network Domestic	14.086	0.312	0.140	4.35	0.08	4.43
London Power Networks plc						
Published 2018/19 UoS charges					Supplementary fixed charge p/MPAN/day	Revised fixed charge p/MPAN/day
	Unit rate 1 p/kWh	Unit rate 2 p/kWh	Unit rate 3 p/kWh	Fixed charge p/MPAN/day		
Domestic Unrestricted	1.650			4.15	0.08	4.23
Domestic Two Rate	2.078			4.15	0.08	4.23
LV Network Domestic	8.049	0.295		4.15	0.08	4.23
South Eastern Power Networks plc						
Published 2018/19 UoS charges					Supplementary fixed charge p/MPAN/day	Revised fixed charge p/MPAN/day
	Unit rate 1 p/kWh	Unit rate 2 p/kWh	Unit rate 3 p/kWh	Fixed charge p/MPAN/day		
Domestic Unrestricted	2.187			4.35	0.08	4.43
Domestic Two Rate	2.657	0.439		4.35	0.08	4.43
LV Network Domestic	13.668	0.664	0.406	4.35	0.08	4.43
Western Power Distribution (East Midlands) plc						
Published 2018/19 UoS charges					Supplementary fixed charge p/MPAN/day	Revised fixed charge p/MPAN/day
	Unit rate 1 p/kWh	Unit rate 2 p/kWh	Unit rate 3 p/kWh	Fixed charge p/MPAN/day		
Domestic Unrestricted	1.957			3.23	0.08	3.31
Domestic Two Rate	2.185	0.807		3.23	0.08	3.31
LV Network Domestic	7.331	1.359	0.802	3.23	0.08	3.31
Western Power Distribution (West Midlands) plc						
Published 2018/19 UoS charges					Supplementary fixed charge p/MPAN/day	Revised fixed charge p/MPAN/day
	Unit rate 1 p/kWh	Unit rate 2 p/kWh	Unit rate 3 p/kWh	Fixed charge p/MPAN/day		
Domestic Unrestricted	2.146			4.21	0.08	4.29
Domestic Two Rate	2.368	1.050		4.21	0.08	4.29
LV Network Domestic	7.253	1.489	1.037	4.21	0.08	4.29
Western Power Distribution (South West) plc						
Published 2018/19 UoS charges					Supplementary fixed charge p/MPAN/day	Revised fixed charge p/MPAN/day
	Unit rate 1 p/kWh	Unit rate 2 p/kWh	Unit rate 3 p/kWh	Fixed charge p/MPAN/day		
Domestic Unrestricted	2.696			5.17	0.08	5.25
Domestic Two Rate	3.035	1.434		5.17	0.08	5.25
LV Network Domestic	13.893	1.806	1.420	5.17	0.08	5.25
Western Power Distribution (South Wales) plc						
Published 2018/19 UoS charges					Supplementary fixed charge p/MPAN/day	Revised fixed charge p/MPAN/day
	Unit rate 1 p/kWh	Unit rate 2 p/kWh	Unit rate 3 p/kWh	Fixed charge p/MPAN/day		
Domestic Unrestricted	2.737			4.50	0.08	4.58
Domestic Two Rate	3.031	1.476		4.50	0.08	4.58
LV Network Domestic	9.929	2.117	1.447	4.50	0.08	4.58

Annex 4: Ofgem decision and Authority directions regarding the Supplier of last resort arrangements - Request for derogations on recovery of costs in respect of Co-Operative Energy Limited's Last Resort Supply Payment claim



Making a positive difference
for energy consumers

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Date: 6 February 2018

Dear Lee,

Supplier of last resort arrangements - Request for derogations on recovery of costs in respect of Co-Operative Energy Limited's Last Resort Supply Payment claim

This letter covers a direction on all electricity Distribution Network Operators (DNOs) to provide derogations from the common distribution charging methodology and a requirement to provide 15 months' notice of changes to distribution network charges.

Background and summary

Supplier of Last Resort and Last Resort Supply Payment processes

We appointed Co-Operative Energy Limited (CEL) as the Supplier of Last Resort (SoLR) to the gas and electricity customers of GB Energy Supply Limited (GBES) with effect from 30 November 2016, after the latter ceased trading.¹ Once appointed, a SoLR may make a claim for a Last Resort Supply Payment (LRSP) from relevant gas and electricity distributors where we have given our consent to the amount claimed.²

On 13 November 2017, CEL submitted notice of its intention to claim for a LRSP. Following consultation, we published our decision to consent to CEL claiming a LRSP of up to £14.04m on 19 January 2018, and claiming £7.72m from relevant electricity distribution licensees.³

Impact on electricity distribution use of system charges

The electricity distribution network in Great Britain consists of 14 distribution service areas (DSAs), each operated by a DNO. GBES supplied customers in all 14 electricity distribution areas at the time of our last resort supply direction.⁴

¹ We gave CEL last resort supply directions under their gas and electricity supply licences on 28 November 2016, effective from 30 November 2016 and available here: <https://www.ofgem.gov.uk/publications-and-updates/direction-appoint-cooperative-energy-gas-supplier-last-resort> and <https://www.ofgem.gov.uk/publications-and-updates/direction-appoint-cooperative-energy-electricity-supplier-last-resort>.

² Under standard licence condition 9 of the electricity supply licences, relevant distributors are distributors in whose distribution service areas there were premises supplied under the Last Resort Supply Direction, excluding independent distribution network operators.

³ <https://www.ofgem.gov.uk/publications-and-updates/last-resort-supplier-payment-claim-co-operative-energy-final-decision>

⁴ This includes customers connected to Independent Distribution Network Operators' (IDNOs') networks.

DNOs recover their allowed revenue from customers through distribution use of system (DUoS) charges. SLC13 of the electricity distribution licence states that the licensee must at all times have in force a Use of System charging methodology that has been approved by us. The methodology for calculating these charges for customers connected at low and high voltages is the Common Distribution Charging Methodology (CDCM). The CDCM is set out in the Distribution Connection and Use of System Agreement (DCUSA), which requires DNOs to provide 15 months' notice of any change to their DUoS charges unless we direct that the 15-month period of notice need not apply. Where we make such a direction, the notice period must be 40 days.

SLC38 of the electricity distribution licence states that a DNO receiving a claim for a LRSP must increase its DUoS charges in the following regulatory year (if the claim is received more than 60 days before the start of the regulatory year), or the year after (if the claim is received less than 60 days before the start of the regulatory year), to recover the amount of the claim. CEL submitted a claim to DNOs on 25 January 2018 meaning that DNOs must amend the DUoS charges that will be effective from 1 April 2018.

Each DNO must then calculate the revenue it has derived from the increase to its 2018/19 DUoS charges, and determine whether there is a shortfall or excess to the revenue targeted (the Specified Amount as defined in SLC38 of the electricity distribution licence). Any such shortfall or excess must be corrected by a change to its DUoS charges in the following regulatory year (i.e. 2019/20). SLC38 provides no means for any outstanding shortfall or excess remaining at the end of the second year to be corrected.

This raises a number of issues when considered against the other requirements of the electricity distribution licence and DCUSA. DNOs have subsequently submitted to us a request that we provide:

- consent under clause 19.1B of the DCUSA that the periods of notice described in clause 19.1A of the DCUSA need not apply; and
- consent for electricity distribution licensees to charge other than in accordance with the charging methodologies approved under SLC13 of the electricity distribution licence (the CDCM).

DNOs' proposed approach

DNOs propose to charge other than in accordance with the CDCM as approved under SLC13, to allow the recovery of CEL's LRSP costs, in both the Relevant Regulatory Year (2018/19) and the year following the Relevant Regulatory Year (2019/20), via a supplementary fixed charge. You have written to us on behalf of all DNOs to request a derogation from SLC13 of the electricity distribution licence and clause 19.1A of DCUSA to allow this to happen.

The resulting supplementary fixed charge will be added by each DNO to the residential customer tariff of each relevant DNO MPAN belonging to it within its Distribution Service Area.

DNOs have forecast the impact of the proposed change as an increase across all DNOs of 0.08 pence per day or £0.29 per annum for each residential customer.

Our decision and next steps

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

We agree that in this case a derogation from SLC13 of the electricity distribution licence is necessary to add a supplementary fixed charge to residential charges. A derogation is also

required from clause 19.1A of the DCUSA to enable these charges to be effective from 1 April 2018 in accordance with SLC38 of the electricity distribution licence (with any excess or under recovery being reflected in the charges effective from 1 April 2019).

We note that the approach taken by the DNOs will result in increases for residential customers connected to DNO networks, but not for those customers on IDNO networks or for non-residential customers. Our view is that all consumers benefit from the protections provided by the SoLR process and that in principle the cost should be spread across all consumers. However, we acknowledge at this stage the approach proposed is pragmatic, given the circumstances and the timings associated with the CEL's claim and the current LRSP process.

We have assessed this case on its own merits and consider the approach proposed by the DNOs to be a pragmatic and proportionate solution in this case. We will assess any future derogation requests on their merits and this decision does not fetter our discretion when considering any requests in the future.

For the avoidance of doubt, as in this instance no additional costs are being incurred by IDNOs, we do not expect IDNOs to increase charges to their customers. We will however work with the DNOs and IDNOs to review the LRSP arrangements.

Direction

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

Yours sincerely,

A handwritten signature in blue ink that reads "Andy Burgess". The signature is written in a cursive style with a large initial 'A'.

Andy Burgess

**Associate Partner, Energy System Integration
For and on behalf of the Authority**

Annex

Direction made by the Gas and Electricity Markets Authority

To:

1. Electricity North West Limited;
2. Northern Powergrid (Northeast) Limited;
3. Northern Powergrid (Yorkshire) plc;
4. SP Distribution plc;
5. SP Manweb plc;
6. Scottish Hydro Electric Power Distribution plc;
7. Southern Electric Power Distribution plc;
8. Eastern Power Networks plc;
9. London Power Networks plc;
10. South Eastern Power Networks plc;
11. Western Power Distribution (East Midlands) plc;
12. Western Power Distribution (West Midlands) plc;
13. Western Power Distribution (South West) plc; and
14. Western Power Distribution (South Wales) plc.

WHEREAS:

- A. Each of the companies to whom this Direction is addressed (each a "Licensee") holds a licence granted, or treated as granted, pursuant to section 6(1)(c) of the Electricity Act 1989 (the "Distribution Licence").
- B. Standard Licence Condition ("SLC") 38.2 of the Distribution Licence requires each Licensee to increase its Use of System Charges for the relevant regulatory year in response to a valid claim for a Last Resort Supply Payment. If the claim is submitted at least 60 days before the following regulatory year, each Licensee must increase its Use of System Charges and publish the changes prior to the following regulatory year.
- C. SLC 13.1 of the Distribution Licence requires each Licensee to comply with the Charging Methodology as set out in SLC 13 and as approved by us. SLC 13.1 gives us the power to derogate each Licensee from the obligation to comply with the Charging Methodology.
- D. SLC 20.3 of the Distribution Licence requires each Licensee to comply with (among other codes) the Distribution Connection and Use of System Agreement ("DCUSA"). Clause 19.1A of the DCUSA requires each Licensee to provide notice of their charges 15 months in advance of the relevant charging year. Clause 19.1B permits each Licensee to not have to comply with the notice period set out in Clause 19.1A where we issue a direction to that effect. In such a circumstance, the notice period will automatically be 40 days.
- E. We appointed Co-Operative Energy Limited ("CEL") as a Supplier of Last Resort with effect from 30 November 2016. On 13 November 2017, CEL submitted its claim for a Last Resort Supply Payment ("CEL LRSP Claim") which GEMA approved on 19 January 2018. The CEL LRSP Claim was submitted to each Licensee at least 60 days prior to the start of the relevant regulatory year.
- F. Compliance with SLC 38.2 will mean that each Licensee will be unable to comply with its

obligations under SLC 13.1 to charge in accordance with the charging methodologies approved pursuant to SLC 13. Compliance with SLC 38 will also mean that each Licensee is unable to comply with Clause 19.1A of the DCUSA to give 15 months' notice of its charges ahead of the relevant charging year.

- G. We therefore consider it appropriate to make the Directions set out below, for the reasons set out in the accompanying letter dated 6 February 2018, which constitutes notice of our reasons pursuant to the Electricity Act 1989.

NOW THEREFORE:

1. The Authority hereby directs that:
 - A. pursuant to SLC 13.1, each Licensee is not required to comply with its obligation to charge in accordance with the charging methodologies approved pursuant to SLC 13, insofar as this is necessary so that each Licensee can comply with its obligation under SLC38.2 following the CEL LRSP Claim;
 - B. pursuant to SLC 20.7, each Licensee is not required to comply with its obligation to provide 15 months' notice of any change to its use of system charges pursuant to clause 19.1A of the DCUSA, insofar as this is necessary so that each Licensee can comply with its obligation under SLC 38.2 following the CEL LRSP Claim.

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

Dated: 6 February 2018



ANDY BURGESS
Associate Partner, Energy System Integration
Signed for and on behalf of the Authority