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Dear Andrew

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 Octopus 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 Octopus Energy Limited's ("Octopus") approved last resort supply payment (LRSP) claim as defined in standard condition 38 of the electricity distribution licence (hereafter "SLC38"), i.e. the "Valid Claim".

Specifically, we are requesting that the Authority 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, hereafter "the 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 charges as described in SLC38. However, subject to modifications to the licence which Ofgem is currently consulting on¹ being implemented, any shortfall or excess revenue will be recovered/returned in accordance with the new

¹ <https://www.ofgem.gov.uk/publications-and-updates/statutory-consultation-modification-electricity-distribution-licence-recover-costs-associated-appointing-supplier-last-resort>

standard condition 38A '*Treatment of unresolved payment claims for last-resort supply where Valid Claim is received before 1 April 2019*' (hereafter "SLC38A").

Octopus' Valid Claim was received by DNOs on 30 January 2019. As this date was more than 60 days prior to the start of 2019/20, the Relevant Regulatory Year for the purposes of SLC38 is the year commencing on 1 April 2019, and therefore the year following the Relevant Regulatory Year is the year commencing on 1 April 2020.

As the modifications to the licence are not yet in force, DNOs must follow existing licence obligations. We therefore propose to use a methodology consistent with that used to recover Co-operative Energy Limited's (CEL's) Valid Claim, as set out in our request for directions² in February 2018.

Background

On 31 July 2018, the Authority appointed Octopus as the supplier of last resort (SoLR)³ to the gas and electricity customers of Iresa Limited ("Iresa") following the revocation of Iresa's gas⁴ and electricity⁵ supply licences. At the time of failure, Iresa held credit balances in respect of a number of its customers, which were subsequently transferred to Octopus.

Octopus submitted an LRSP claim primarily to recover the credit balances which were transferred to it as part of its appointment as the SoLR. Ofgem published its minded to decision⁶ on 14 December 2018, outlining that it was minded to consent to Octopus claiming an LRSP of up to £13.8m.

Under standard condition 9 of the electricity supply licence (hereafter "SLC9"), Octopus may make a claim from each electricity distribution licensee which distributed electricity to customers that Iresa supplied at the time of failure. We note that under the recently amended SLC9, future LRSP claims will be recovered from each distribution licensee in whose licence part B has effect (i.e. the 14 DNO licensees). As all DNOs distributed electricity to the former customers of Iresa, the total LRSP claim will be split between the 14 DNOs in proportion to their combined total customer numbers as published in the respective 2017/18 regulatory reporting packs.

In its final decision⁷, published on 24 January 2019, the Authority determined the value of Octopus' claim to be £13.2m⁸, of which DNOs collectively will be liable for £7.2m⁹ (55%).

Under SLC38, a DNO receiving a Valid Claim must increase its use of system 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 Octopus submitted its Valid Claim before 31 January 2019 (i.e. more than 60 days before the start of 2019/20), each DNO must increase its use of system charges in 2019/20 (i.e. effective from 1 April 2019). In due course, each DNO must calculate the revenue it has derived from the increase to its 2019/20 use of system 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 use of system charges in the following regulatory year (i.e. 2020/21). SLC38 provides no means for any

² <http://www.northernpowergrid.com/asset/0/document/4097.pdf>

³ https://www.ofgem.gov.uk/system/files/docs/2018/07/last_resort_supply_direction_-_electricity.pdf

⁴ https://www.ofgem.gov.uk/system/files/docs/2018/08/notice_of_revocation_of_gas_supply_licence_-_iresa.pdf

⁵ <https://www.ofgem.gov.uk/publications-and-updates/iresa-limited-notice-revocation-electricity-supply-licence>

⁶ <https://www.ofgem.gov.uk/publications-and-updates/last-resort-supplier-payment-claim-octopus-energy>

⁷ <https://www.ofgem.gov.uk/publications-and-updates/last-resort-supplier-payment-claim-octopus-energy-final-decision>

⁸ Precisely, £13,158,974

⁹ Precisely, £7,237,436

outstanding shortfall or excess remaining at the end of the second year to be corrected. However, subject to modifications to the licence being implemented, any shortfall or excess revenue will be recovered/returned in accordance with the new SLC38A.

We note that Ofgem's final decision to allow Octopus to claim £13.2m is *"conditional upon Octopus adjusting the final amount claimed to reflect the final, agreed credit balance for all relevant customer accounts"*. Of the £13.2m, £10.9m relates to credit balances, and of which 9% are estimated. Any adjustment to the amount claimed is expected to be remedied by modifications to the licence. It is expected that Octopus will either return surplus costs to, or recover additional costs from, DNOs (and gas equivalents) proportionate to the respective Valid Claim. Each DNO will then adjust its allowed distribution network revenue accordingly via the two-year lagged pass-through mechanism.

Without modifications to the licence the earliest DNOs will recover and pay additional costs to Octopus in 2020/21. SLC38 primarily facilitates DNO recovery of a Valid Claim whereby the DNO is required to increase use of system charges, and then provides for the return of excess (or recovery of a shortfall in) revenue relative to that Valid Claim value i.e. the Specified Amount. Therefore, and subject to the methodology used (e.g. fixed charges are rounded to two decimal places) and number of other Valid Claims received, a DNO could recover a new Valid Claim from Octopus in accordance with SLC38. However, SLC38 would only facilitate the return of Octopus' surplus costs if the Specified Amount is interpreted as being the combined value of the original and new Valid Claim. Therefore SLC38 will not provide a DNO with the means of returning Octopus' surplus costs via a new Valid Claim whereas the proposed licence modifications will.

The principles set out above would also apply in a circumstance where Octopus subsequently recovered a proportion of the costs it is claiming via the liquidation of Iresa.

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 use of system 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 use of system charges. This is a contractual requirement that applies in addition to any licence obligations. In accordance with this requirement, use of system charges for 2019/20 were published in December 2017, and for 2020/21 in December 2018. Therefore, as a result of the requirement to give 15 months' notice of a change to use of system charges, charges for both the Relevant Regulatory Year and the year following the Relevant Regulatory Year have been published by DNOs.

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

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. 2019/20 and 2020/21. 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 and therefore must publish revised 2019/20 use of system charges by 20 February 2019. 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 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. SLC38 does not specify any methodology by which an increase to use of system charges should be calculated and applied.

We propose to adopt the same methodology used to recover CEL's Valid Claim i.e. a supplementary daily fixed charge will be applied to residential customers. The reasons for choosing this methodology were originally set out in our request for directions in order to recover CEL's Valid Claim. The recovery of such costs from residential customers only is further, and primarily justifiable on the basis that the safety net¹⁰ provided by the appointment of a SoLR does not protect the credit balances of 'business customers'. Credit balances (83% of the Octopus claim) and the cost of financing credit balances (12% of the Octopus Claim) represent the vast majority of costs a SoLR is seeking to recover.

Further, and consistent with the recovery of CEL's Valid Claim, at Ofgem's request the supplementary fixed charge will not be applied to customers connected to networks operated by either independent distribution network operators (IDNOs) or DNOs operating outside of their Distribution Services Area, which the DCUSA defines collectively as licenced distribution network operators (LDNOs).

This agreement continues to be predicated on the basis that:

- the Authority is not setting a precedent for future LRSP claims;
- the Authority is clear in, and will enforce, its expectation that the LDNOs will not subsequently increase their use of system charges up to the charge which the host 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 Octopus' Valid Claim;
- Changes to licence conditions are expected to be implemented in due course which will ensure customers connected to LDNOs contribute to the recovery of Valid Claims, and subject to the approval of DCUSA change proposal (DCP) 332 '*Appropriate treatment and allocation of Last Resort Supply Payment claim costs*' will ensure that LDNOs do not unduly benefit as a result.

Issue two - direction sought

Consent from the Authority is requested to allow DNOs to charge other than in accordance with their charging methodologies as approved under SLC13, to allow the recovery of Octopus' Valid Claim, in both the Relevant Regulatory Year (2019/20) and the year following the Relevant Regulatory Year (2020/21), 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.

¹⁰ <https://www.ofgem.gov.uk/consumers/household-gas-and-electricity-guide/extra-help-energy-services/ofgem-safety-net-if-your-energy-supplier-goes-out-business>

The proposed methodology for calculating the supplementary fixed charge in 2019/20 is outlined below, with Table 1 showing the Specified Amount each DNO is required to recover in respect of Octopus' claim.

DNO	Total Number of Premises (000s)*	Proportion of Total Number of Premises	LRSP Claim Amount (£m)
ENWL	2,384	8.0%	0.58
NPg (Northeast)	1,602	5.4%	0.39
NPg (Yorkshire)	2,299	7.7%	0.56
SHEPD	773	2.6%	0.19
SEPD	3,050	10.2%	0.74
SP Distribution	2,007	6.7%	0.49
SP Manweb	1,513	5.1%	0.37
UKPN (EPN)	3,628	12.2%	0.88
UKPN (LPN)	2,346	7.9%	0.57
UKPN (SPN)	2,297	7.7%	0.56
WPD (East Midlands)	2,647	8.9%	0.64
WPD (South Wales)	1,133	3.8%	0.28
WPD (South West)	1,613	5.4%	0.39
WPD (West Midlands)	2,482	8.3%	0.60
Total	29,774		7.24

* Based on 2017/18 Regulatory Reporting Pack (RRP) submission (Cost and Volumes Pack Table M14)

Table 1 - Breakdown of total Valid Claims by DNO

Consistent with the recovery of CEL's Valid Claim, to calculate the necessary charge per customer we have used the forecast of customer numbers in the published CDCM model which relates to the Relevant Regulatory Year, and, if necessary, the year following the Relevant Regulatory Year (published in December 2017 in respect of 2019/20 customer counts and in December 2018 in respect of 2020/21 customer counts).

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 LDNO. 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 2019, and the impacted tariffs are presented both before and after this adjustment for each DNO in Appendix 1.

Note that, subject to modifications to the licence being implemented, the same methodology will be applied when calculating any necessary change (increase or decrease) in use of system charges effective from 1 April 2020 in respect of the correction of any shortfall or excess revenue recovery in 2019/20. In such case DNOs will publish revised 2020/21 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	0.58	2,206	0.29	0.08
NPg (Northeast)	0.39	1,479	0.29	0.08
NPg (Yorkshire)	0.56	2,129	0.29	0.08
SHEPD	0.19	704	0.29	0.08
SEPD	0.74	2,862	0.29	0.08
SP Distribution	0.49	1,852	0.29	0.08
SP Manweb	0.37	1,386	0.29	0.08
UKPN (EPN)	0.88	3,397	0.29	0.08
UKPN (LPN)	0.57	2,118	0.29	0.08
UKPN (SPN)	0.56	2,149	0.29	0.08
WPD (East Midlands)	0.64	2,464	0.29	0.08
WPD (South Wales)	0.28	1,050	0.29	0.08
WPD (South West)	0.39	1,469	0.29	0.08
WPD (West Midlands)	0.60	2,291	0.29	0.08
Total	7.24	27,556		

* Based on forecasts used in published 2019/20 CDCM models, excluding 'Related MPAN' and LDNO tariffs

Table 2 - 2019/20 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.

Yours sincerely



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Commercial Manager – Regulated Revenue (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 Hyrdro 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 – 2019/20 use of system charges before and after Octopus Valid Claim adjustment

Electricity North West Limited	Published 2019/20 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	2.388			3.59	0.08	3.67
Domestic Two Rate	2.794	0.766		3.59	0.08	3.67
LV Network Domestic	10.409	2.078	0.744	3.59	0.08	3.67

Northern Powergrid (Northeast) Limited	Published 2019/20 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	2.355			5.49	0.08	5.57
Domestic Two Rate	2.674	1.131		5.49	0.08	5.57
LV Network Domestic	7.567	1.910	1.117	5.49	0.08	5.57

Northern Powergrid (Yorkshire) plc	Published 2019/20 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	1.832			5.70	0.08	5.78
Domestic Two Rate	2.083	1.065		5.70	0.08	5.78
LV Network Domestic	4.773	1.730	1.038	5.70	0.08	5.78

SP Distribution plc	Published 2019/20 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	2.618			4.55	0.08	4.63
Domestic Two Rate	3.056	1.286		4.55	0.08	4.63
LV Network Domestic	9.419	2.005	1.227	4.55	0.08	4.63

SP Manweb plc	Published 2019/20 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	3.356			3.60	0.08	3.68
Domestic Two Rate	3.686	1.545		3.60	0.08	3.68
LV Network Domestic	12.266	2.621	1.453	3.60	0.08	3.68

Scottish Hyrdro Electric Power Distribution plc	Published 2019/20 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	3.369			6.60	0.08	6.68
Domestic Two Rate	3.777	2.112		6.60	0.08	6.68
LV Network Domestic	9.212	2.948	1.851	6.60	0.08	6.68

Southern Electric Power Distribution plc	Published 2019/20 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	2.092			3.02	0.08	3.10
Domestic Two Rate	2.572	0.637		3.02	0.08	3.10
LV Network Domestic	8.723	1.369	0.579	3.02	0.08	3.10

Eastern Power Networks plc	Published 2019/20 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	2.121			4.79	0.08	4.87
Domestic Two Rate	2.613	0.193		4.79	0.08	4.87
LV Network Domestic	14.625	0.422	0.160	4.79	0.08	4.87

London Power Networks plc	Published 2019/20 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	1.947			4.00	0.08	4.08
Domestic Two Rate	2.512			4.00	0.08	4.08
LV Network Domestic	9.557	0.481		4.00	0.08	4.08

South Eastern Power Networks plc	Published 2019/20 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	2.439			4.57	0.08	4.65
Domestic Two Rate	3.007	0.509		4.57	0.08	4.65
LV Network Domestic	14.861	0.854	0.457	4.57	0.08	4.65

Western Power Distribution (East Midlands) plc	Published 2019/20 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	2.060			3.03	0.08	3.11
Domestic Two Rate	2.291	0.898		3.03	0.08	3.11
LV Network Domestic	7.566	1.544	0.894	3.03	0.08	3.11

Western Power Distribution (West Midlands) plc	Published 2019/20 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	2.196			4.14	0.08	4.22
Domestic Two Rate	2.405	1.092		4.14	0.08	4.22
LV Network Domestic	7.500	1.613	1.084	4.14	0.08	4.22

Western Power Distribution (South West) plc	Published 2019/20 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	2.750			5.02	0.08	5.10
Domestic Two Rate	3.013	1.425		5.02	0.08	5.10
LV Network Domestic	14.414	1.806	1.417	5.02	0.08	5.10

Western Power Distribution (South Wales) plc	Published 2019/20 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	2.878			4.29	0.08	4.37
Domestic Two Rate	3.052	1.583		4.29	0.08	4.37
LV Network Domestic	10.564	2.152	1.574	4.29	0.08	4.37