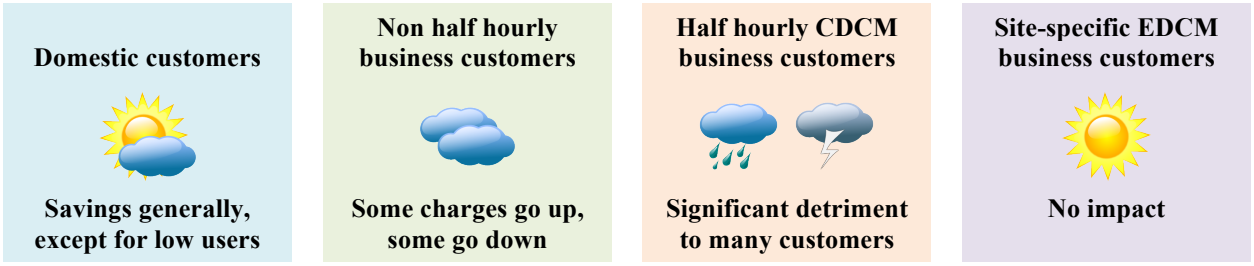
Last chance to react to electricity industry proposals to impose large increases in network charges for business off-peak use



1. This alert is about a proposal of the electricity industry to make significant changes to the network charges for use of the distribution network from 1 April 2016. The proposal would lead to a large increase in the charges applied to off-peak use, and to an overall increase in charges for most large business use.

2. An industry consultation has been run but there was no customer response. Time will soon be running out to make representations to Ofgem.

What is the impact?

3. Outside Greater London:

   (a) Off-peak unit rates, particularly green and amber unit rates, are increased by up to 1.094 p/kWh. As a percentage, the increase reaches 9400 per cent in one case.

   (b) Unit rates that apply at peak time are significantly reduced: up to 16.016 p/kWh.

   (c) Capacity charges are increased by up to 5.33 p/kVA/day or up to 140 per cent.

   (d) Fixed charges are increased by up to 119 per cent.

4. In Greater London, the impact is a reduction in off-peak unit rates, in many cases down to zero; and a modest increase in charges in respect of domestic customers.

5. Appendix A contains additional illustrations for a half hourly metered high-voltage customer who has shifted its consumption to off-peak hours in the green time band.

Why is the electricity industry making these proposals now?

6. An industry working group made up of people with experience in electricity supply and electricity distribution was established to address the issue of very high unit rates in the red time band. The problem was that these rates were significantly in excess of any measure of cost. The reason for these excessive charges was "revenue matching", which is a significant driver of distribution charges within the CDCM.

7. The group examined a simple scaling solution, which would have spread the revenue matching element more widely as a proportionate mark-up on cost estimates, and would have tended to reduce charges to business users. It then moved towards a

hybrid solution whose main feature is to transfer charges from the red time band to other elements, particularly the green (off peak) time band, and to apply this charge to all users and all time bands without any regard to differences in cost between them.

8. The effect of the working group's hybrid solution is to reduce charges to domestic customers, particularly in high-cost areas such as Wales. This might be attractive to electricity suppliers who are under intense political pressure to cut domestic tariffs.

How to make your voice heard

9. The proposed change is under DCUSA, a governance regime overseen by Ofgem. This change will only be implemented if Ofgem approves it.

10. The industry conducted two consultations; see http://reckon.co.uk/c91335.zip for the most recent one. There were **no customer responses to the industry consultation**. The industry consultation documents were difficult to read and the impact of the proposal might not have been clear from them.

11. The only effective way to make representations now is to go directly to Ofgem to register concerns about the proposal and/or about the industry consultation process. The responsible official at Ofgem is **Iain Morgan (iain.morgan@ofgem.gov.uk)**.

12. If Ofgem agrees that the industry has failed to consult effectively, it can "send back" the change report to the industry for further work. If Ofgem is not persuaded that the proposal would improve the charging methodology, it can reject it altogether.

For more information about this alert

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13. There is nothing confidential in this alert. Feel free to pass it on to others who might be interested or to include it with any consultation response you make. Microsoft Word and PDF versions of this alert, and of any further updates on this topic or other areas of interest to electricity customers, can be found at **http://dcmf.co.uk/alerts**.

Appendix A — Example of tariff impact on HV business off-peak use

14. The following table shows, for each DNO area, the distribution network charges with and without DCP 123 for a high-voltage (HV) customer with a Maximum Import Capacity of 5,000 kVA and which consumes 4,500 kW for 11 off-peak (green) hours each day.

	Illustrative distribution charges before the change £/year	Illustrative distribution charges after the change £/year	Illustrative cost of the change £/year	Illustrative cost of the change £/MWh
ENWL	76,614	204,260	127,646	7.1
NPG Northeast	45,572	225,259	179,687	9.9
NPG Yorkshire	38,316	175,523	137,207	7.6
SPEN SPD	91,538	191,560	100,022	5.5
SPEN SPM	98,992	335,791	236,799	13.1
SSEPD SEPD	95,415	199,583	104,169	5.8
SSEPD SHEPD	231,298	474,039	242,740	13.4
UKPN EPN	77,127	85,276	8,149	0.5
UKPN LPN	141,330	130,198	(11,132)	(0.6)
UKPN SPN	74,316	163,760	89,444	5.0
WPD EastM	73,407	160,543	87,135	4.8
WPD SWales	73,332	325,026	251,694	13.9
WPD SWest	53,957	293,680	239,723	13.3
WPD WestM	86,350	223,052	136,702	7.6

15. My scenario analysis tools and compilations of public data can be accessed through **http://dcmf.co.uk/models/dcp123.html**.

16. The figures in the table above are my own estimates, based on data and models published by DNOs. There might be small differences in the data or assumptions with industry consultation documents in cases where I have not used exactly the same assumptions. There is also a risk that I have made an error — do not hesitate to contact me if anything looks strange or if you would like any help with understanding these data, or the impact on your business.

Appendix B — Critical review of the Working Group's principles

17. The Working Group says that it has adopted a principle to maintain the pre-scaled (i.e. cost-based) absolute differential between tariffs in the final tariffs.

18. This means, for example, that if the analysis of costs produces an average unit rate of 2 p/kWh for domestic customers and unit rates of 10 p/kWh, 1 p/kWh and 0.01 p/kWh for HV red, amber and green units respectively, and if reaching the DNO's revenue target requires the domestic unit rate to be increased to 2.6 p/kWh, then the HV rates are 10.6 p/kWh, 1.6 p/kWh and 0.61 p/kWh. Thus, in this example (which is realistic), the green charging rate is set to 61 times modelled costs.

19. The alternative, which the Working Group rejected, would have been to apply revenue matching as a simple uniform percentage mark-up. In the example above, assuming that the domestic tariff still comes to 2.5 p/kWh, then the HV rates would be 13 p/kWh, 1.3 p/kWh and 0.013 p/kWh, all 30 per cent above modelled costs.

20. The Working Group has also adopted the idea of applying part of revenue matching to fixed and capacity charges. Because only large business users pay for capacity, the effect is to increase further the proportion of the charges borne half hourly metered users compared to the current approach, where all revenue matching is applied to unit rates, which all customer categories pay for. The Working Group's solution also penalises half hourly metered users compared to a simple percentage mark-up, because the simple mark-up would apply in the same way to all network capacity costs whether they are charged through capacity charges (for half hourly metered users) or through fixed and unit rates (for non half hourly metered users).

21. The Working Group does not apply its own principles to LDNO tariffs. These are calculated by applying the same discount to each all-the-way tariff component. Thus, revenue matching generally increases the undue differential between a HV all-the-way tariff and a HV boundary LV end user tariff, even if these two tariffs relate to the same use of the DNO's network. Whilst this might not be anti-competitive (because it favours LDNOs by inflating their margins), it might lead to excessive all-the-way charges and/or to undue discrimination against private network operators.

22. The logic of the Working Group's principle is that the only customer choices that should not be distorted are between consumption at different times or at different voltage levels within the same DNO area. The Working Group's principle makes no attempt at controlling how revenue matching distorts other choices, such as:

    (a) between consuming in different DNO areas; or

    (b) between consuming electricity (e.g. to recharge a fleet of electric vehicles) and not consuming electricity (e.g. by opting for diesel vehicles); or

    (c) between an all-the-way supply and a supply involving a LDNO.

23. I think that this focus is wrong and has led the Working Group to adopt an inappropriate principle. I have criticised the principle and the DCP 123 solution in my response to a previous industry consultation, which is published on **http://dcmf.co.uk/publications/**.