

DPCR5 and CE Electric UK – a briefing for stakeholders and customers

This note is aimed at providing information for stakeholders and customers relating to our charges for use of the electricity distribution network from April 2010. These charges will be impacted by two current major developments: our regulator Ofgem's distribution price review (known as DPCR5) and changes to the distribution charging methodology. Because both of these activities are currently ongoing, we are not yet in a position to say what the impact for charges will be. This note therefore describes the current position on these two activities, how they interact and our plans for providing clearer information in due course.

Ofgem has issued its initial proposals for DPCR5 at the beginning of August. These are aimed at delivering further improvements in customer service from distribution network operators (DNOs), such as our two licensed distribution businesses, Northern Electric Distribution Limited (NEDL) and Yorkshire Electricity Distribution plc (YEDL), maintaining high network reliability and paving the way for further carbon reductions. Ofgem regulates the allowed revenues and expenditure of the DNOs through price controls that are reviewed every five years; these current proposals cover 2010-2015. Ofgem will consult on these initial proposals over the autumn and will make final proposals in the winter.

In broad terms, Ofgem have proposed a level of allowances that across the country would equate to an average increase above inflation of around 5% in use of system charges to customers for each of the next five years (around £3 to £4 per domestic customer per year). The proposed annual allowed revenue increases in respect of CE Electric UK's DNO businesses are 7.0% for NEDL and 5.6 for YEDL. However, because of other work which is currently ongoing to introduce a common approach to tariffs across all DNOs, the Common Distribution Charging Methodology (CDCM), some customer groups could face changes in charges that are significantly different from this estimated headline percentage. Nor would it be prudent to use these annual allowed revenue increases in isolation as a guide to future use of system charges as there are a number of other factors that will affect future distribution use of system (DUoS) charges including:

- Ofgem's initial proposals are subject to consultation and their final proposals may be different. In particular, the proposed annual revenue increases currently assume no change in the cost of capital and pensions costs. These are both material items in the settlement and decisions that are taken on these issues could significantly affect the final income levels;
- Ofgem's initial and final proposals are DNO specific and outcomes will be different for different companies;
- DNOs will be working individually with Ofgem to respond to aspects raised in the initial proposals and discussions may lead to revised allowances in the final proposals;
- The proposals are based on Ofgem's view of performance against incentive mechanisms and do not factor in any over/under-recovery positions from tariff levels in previous years;
- The review of the structure of DUoS charges to produce a national common charging methodology for low-voltage (LV) and high-voltage (HV) customers from April 2010 will change the way that costs are allocated between types of customers; and

- The review of the structure of use of system charges to produce a common charging methodology for extra-high voltage (EHV) customers will change the way charges are constructed for this group of customers from April 2011.

The price control proposals include funding for upgrades of networks that were largely built in the 1950s and 1960s, as well as incentives on companies to invest for a low-carbon future, to connect distributed generation over the next five years and to cut network losses. However, in acknowledging the need to invest in the networks Ofgem have also recognised the need to avoid unnecessary price rises in today's difficult economic climate.

Ofgem's initial proposals include a view that CE is a "well run DNO group", which is reflected in our performance on operational costs and is also the case for much of our network investment. They also say that we have a generally robust approach to asset management supported by well developed policies and long term plans.

As mentioned above, the changes to the charging methodology will mean that, later this year the DNOs nationally will change the structure of distribution use of system (DUoS) charges to make them better reflect the cost of serving different groups of customers. This is important for climate change as it will, for example, reward local generation connecting to the distribution network and provide improved cost signals for demand and generation customers.

The DNOs are still working through the details and will be submitting proposals to Ofgem at the end of August 2009, which will compare the new charges to those already published for April 2009 - it is expected that Ofgem will then consult on these proposals. If the proposal is not vetoed by Ofgem then DNOs will update their forecasts and publish indicative charges for April 2010 in December 2009. The combination of the new distribution price control review and the new charging methodologies are likely to have a significant impact on the level of charges faced by different customer groups. This means that some customer groups may see significant increases in their distribution charges from 1 April 2010 and there may be significant regional variations due to the different underlying cost base of different DNOs at different voltage levels.

The ultimate effect on DUoS bills to individual suppliers will therefore result in a combination of the DPCR5 final settlement, the new charging methodologies, the underlying cost bases of different DNOs and the mix of customers in the supplier's portfolio.

Please find below a link to Ofgem's press release on their initial proposals for DPCR5.

<http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=262&refer=Media/PressRel>