Making a positive difference
for energy consumers

Company Secretary
Scottish and Southern Electricity Networks

Inveralmond House
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By email Emma Clark

Email: duos@ofgem.gov.uk

Date: 20 December 2024

Dear Company Secretary,

Direction issued to Scottish and Southern Electricity Networks (SSEN) to derogate from the Distribution Use of System (DUoS) charge setting notice period[1], issued under Section 2A Clause 19.1B of the Distribution Connection and Use of System Agreement (DCUSA)[2].

This letter contains a Direction to SSEN to derogate from the DUoS 15-month charge setting notice period so that it may publish its final DUoS charges for 2026/27 Scottish Hydro Electric Power Distribution plc (SHEPD) and Southern Electric Power Distribution plc (SEPD) after 31 December 2024. The period of notice by which the Distribution Network Operator (DNO) must publish its charges is reduced to forty days, however we expect the DNO to publish those charges as soon as reasonably practicable but no later than 14 February 2025.

We consider it is in the interests of its customers overall, and in particular its Extra High Voltage customers to delay publication of final charges to allow it to mitigate what would

[1] Read Section 2A Clause 19.1A of the DCUSA
[2] Read Section 2A Clause 19.1B of the DCUSA

otherwise have been an exceptional level of volatility of fixed charges for some EHV customers. The Direction is attached as an Annex to this letter.

Background

DNOs recover their allowed revenue from customers through DUoS charges. The methodologies for calculating these charges are the EHV Distribution Charging Methodology (EDCM) for the large, industrial customers connected at the highest voltages, and the Common Distribution Charging Methodology (CDCM) for the remaining customers. The CDCM and EDCM are detailed in the DCUSA document.

In the 2023 charge-setting period, we were made aware of circumstances in which following the EDCM would result in a negative value 'surplus residual'.[3] In some cases, this would result in a fixed daily credit being paid to certain sites. We do not consider that a fixed daily credit for Final Demand Sites is cost-reflective nor conducive to competition in the generation and supply of electricity.

We are similarly aware of limitations with how the CDCM seeks to manage a surplus residual. A process exists to reduce some of the forward-looking charges (discounting fixed charges and unit rates) to bring revenue recovery down to the target value. However, an especially large surplus residual may result in the CDCM exhausting the ability to apply discounting and failing to produce a complete set of charges for some network users. We do not consider that compliance with the Charging Methodology should result in the failure to produce a set of final tariffs.

From the point of the issues within the charging methodologies becoming known to us, we have sought to identify a robust and practical solution.

In response to a surplus residual arising in the EDCM of two DNOs in the 2023 charge-setting period, for 2025/26 charges, we granted a direction to derogate to the affected DNOs to charge outside of the EDCM.[4] We described these issues in greater detail in two explanatory notes[5] published alongside our presentation to the March 2024 Charging Futures Forum.

[3] Surplus residual is also understood as a 'negative residual'. This guidance document uses the term "surplus residual" for consistency with the DCUSA.
[4] Read directions to derogate under SLC 13B Part E of the Electricity Distribution Licence relating to the EDCM for National Grid Electricity Distribution and Scottish and Southern Electricity Networks
[5] Read the explanatory note on the issue relating to the EDCM and the explanatory note on the issue relating to the CDCM on the NESO website

In July 2024, we published a Call for Input[6] to the sector, which detailed and sought feedback on our assessment of proposed approaches to manage the effects of surplus residual charges in both the EDCM and CDCM. We subsequently published our guidance for managing the effects of surplus residual charges[7] in November 2024, which outlined the process by which DNOs should submit requests for direction to derogate from the DCUSA 15-month notice period and relevant Charging Methodologies.

SSEN's issue and requested direction to derogate

Following our published guidance on managing the effects of surplus residual charges in DUoS Charging Methodologies, SSEN has reviewed its available indicative charging figures and assessed the likelihood of an excessive residual surplus occurring as a result of applying the EDCM and CDCM to its licence areas.

In keeping with our guidance and in anticipation of the potential occurrence of an excessive surplus residual arising within either the EDCM or CDCM, SSEN has written to us on 2 December 2024 to request a direction to derogate from the 15-month DUoS charge setting notice period, under Section 2A Clause 19.1B of the DCUSA.

This is with a view for SSEN to follow the subsequent process set out in our guidance. This would involve SSEN submitting a request for direction to derogate from the Charging Methodology, by applying the relevant intervention option outlined in our guidance, should the occurrence of an excessive negative residual in either or both Charging Methodologies be confirmed.

In testing the intervention as per the Guidance, SSEN has highlighted a potential issue with how the EDCM spreadsheet model deals with negative residuals in calculating IDNO discounts. This is currently under investigation by CEPA/TNEI.

Our assessment

We have considered SSEN's proposal to delay publishing final charges for SHEPD and SEPD against the process set out in our guidance for managing the effects of surplus residual charges, which has been developed in accordance with our principal objective and wider statutory duties.

[6] Read the Call for Input on managing the effects of surplus residual charges
[7] Read our guidance for managing the effects of surplus residual charges

We regard SSEN's request to be consistent with our guidance document. By receiving a direction to derogate from the 15-month notice period, SSEN will have sufficient time to confirm the presence of an excessive residual surplus in its charging methodologies, apply the relevant intervention option and produce an impact assessment. It will then submit a request for direction to derogate against the DUoS Charging Methodology to us and subsequently publish final charges following our decision.

In light of the potential issue with the EDCM model identified by SSEN, we consider it appropriate to extend the timetable expected in the Guidance by up to two weeks to allow the issue to be investigated and subsequently addressed if necessary.

Following this approach will allow SSEN to manage the effects of surplus residual charges within the EDCM and therefore avoid a fixed daily credit being paid to some sites. We do not consider that a fixed daily credit for Final Demand Sites is cost-reflective nor conducive to competition in the generation and supply of electricity.

We therefore consider that a delay to publication of charges, that will enable a potential subsequent request to derogate from the Charging Methodologies, would better facilitate the achievement of our principal objective and wider statutory duties.

Impact on licensed distribution network operators (LDNO)[8] operating in Scottish Hydro Electric Power Distribution plc (SHEPD) and Southern Electric Power Distribution plc distribution licence areas

Under the DCUSA, LDNOs are required to provide 14 months' notice of their charges. This is one month after the DNOs publish their own tariffs. Any directions to DNOs to derogate from the 15-month notice period would therefore have implications for LDNOs operating in those DNO areas.

We are considering a proportionate approach to affected LDNOs in ensuring compliance with their notice period obligations. We will further engage these parties and consider whether any additional interventions are required in early January 2025, once we have confirmation of which DNOs are affected by an excessive surplus residual.

Decision

[8] LDNO can either ben an Independent Distribution network operator (IDNO) or a DNO operating outside of its own region.

For reasons set out above we have decided to grant the SSEN a direction to derogate from the 15-month DUoS charge setting notice period as set out in the Annex below. The Direction issued under Section 2A Clause 19.1B of the DCUSA is attached as an Annex to this letter.

In the event that the SSEN's ordinary calculation of charges does not result in an excessive surplus residual being produced, we expect it to publish tariffs by 31 December 2024.

This letter constitutes notice under 49A of the Electricity Act 1989.

If you have any queries or comments in relation to the issues raised in this letter, please contact us by email at duos@ofgem.gov.uk

Yours faithfully,

Andrew Malley
Head of Distribution and Residual Charging
Signed on behalf of the Authority and authorised for that purpose

Annex

Direction issued to Scottish Hydro Electric Power Distribution plc and Southern Electric Power Distribution plc to derogate from the Distribution Use of System (DUoS) charge setting notice period, issued under Section 2A Clause 19.1B of the Distribution Connection and Use of System Agreement (DCUSA)

1. Scottish Hydro Electric Power Distribution plc and Southern Electric Power Distribution plc**,** to whom this Direction is addressed (a "Licensee") holds a licence granted, or treated as granted, pursuant to section 6(1)(c) of the Electricity Act 1989 (the "Distribution Licence").

2. 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 the Authority issues a direction to that effect. In such a circumstance, the notice period will be forty days.

Now therefore:

The Authority hereby directs:

Pursuant to Section 2A Clause 19.1B of the DCUSA, that the periods of notice described in Clause 19.1A shall not apply to the Licensee and that the notice period shall instead be forty days for 2026/27 tariffs, however we expect the DNO to publish those charges as soon as reasonably practicable but no later than 14 February 2025.

This Direction shall have effect from the date stated below.

Dated 20 December 2024

Andrew Malley
Head of Distribution and Residual Charging
Signed on behalf of the Authority and authorised for that purpose