



DCUSA Change Report

DCP 094 - Treatment of 'Load related new connections & reinforcement (net of contributions)' in the Price Control Disaggregation Model used to determine LDNO discount factors

1 PURPOSE

- 1.1 This document is issued in accordance with Clause 11.20 of the DCUSA, and details DCP 094 – Treatment of '*Load related new connections & reinforcement (net of contributions)*' in the Price Control Disaggregation Model used to determine LDNO discount factors. The voting process for the proposed variation and the timetable of the progression of the Change Proposal (CP) through the DCUSA Change Control Process is set out in this document.
- 1.2 Parties are invited to consider the proposed amendments (Appendix A), together with the consultation documentation (Appendix B) and submit their votes using the form attached as Appendix C to dcusa@electralink.co.uk by 28 October 2011.

2 SUMMARY

1. DCP 094 was raised by the Electricity Network Company and seeks to change the CDCM methodology such that the cost figures coming under the heading '*Load related new connections & reinforcement (net of contributions)*' are not used in the calculation of weighted average percentages for indirect costs and in the calculation of the proportion of direct costs to indirect costs.
2. The CDCM calculates portfolio tariffs for LDNO networks that connect to a DNO's distribution system by applying LDNO discounts to final tariffs (final tariffs are those calculated in respect of end consumers on the DNO Party's network). Within Step 4 of Schedule 16 in the DCUSA it describes the rules that the CDCM employs to calculate LDNO discounts. In practice these rules are embedded in an Excel workbook entitled "Method M". In calculating the LDNO discounts the methodology allocates certain DNO indirect opex costs to different network levels using different cost drivers.
3. It then calculates weighted average percentages for allocating the DNO opex costs. In practice the weighted average percentages are calculated in the Method M '*WPD – Opex Allocation*' worksheet and used to allocate opex costs in the Method M '*WPD- Final Allocation*' worksheet. In addition, the proportion of direct costs to indirect costs is used in the calculation of LDNO discounts where the LDNO connects to the DNO within a network level where an LDNO connects to the upstream distributor at LV and where the

downstream customer is connected at LV. This will also be true for HV connected sites when DCP 071A¹ is implemented in tariffs from October 2011.

- 2.1 One of the costs used to determine the LDNO discounts is '*Load related new connections & reinforcement (net of contributions)*'. Whilst this is a direct cost and is fully allocated (and therefore is not used to calculate the weighted average percentage of indirect costs between voltage levels), it is nonetheless used to calculate the proportion of direct costs to indirect costs, which is in turn used to determine the LDNO discounts that apply where the LDNO connects to the DNO within a network level.
- 2.2 DCP094 examines the way '*Load related new connections & reinforcement (net of contributions)*' customer contributions and costs, which are allocated in accordance with DNOs' RRP (DNOs' RRP table 2.4), distort the calculation of the proportion of direct costs to indirect costs. The CP explains that these distortions are due to the following reasons:
- All connection costs are allocated to the network level at which the connection is provided; i.e. for a connection provided at LV, costs of providing assets at HV and other network levels are allocated to the LV network level.
 - All Customer contributions are allocated to the LV network level irrespective of the network level at which the connection is provided.
 - This means that net costs at the LV network level are understated (often negative) whilst net costs at other network levels are overstated.

3 DCP 094 – WORKING GROUP

- 3.1 The DCUSA Panel established a Working Group to assess and refine DCP 094.
- 3.2 The DCP 094 Working Group met on 6 occasions and consisted of representatives from DNOs, IDNOs and Ofgem.

¹ <http://www.dcusa.co.uk/Extranet/CP.aspx?id=111>

4 CONSULTATION

- 4.1 The Working Group carried out a Consultation to give Parties an opportunity to review and comment on the CP, and there were seven responses received.
- 4.2 There was unanimous understanding for the CP's principles and intent. However there were comments by Parties regarding the DCUSA objectives and also whether the intent of the CP is adequately met.
- 4.3 The consultation asked whether DCP094 better facilitates the DCUSA General and Charging objectives. Two respondents felt that this CP does not better facilitate any of the relevant objectives.
- 4.4 One respondent felt that there was a lack of detail within the source data to identify values expressing the correct weighting in relation to direct cost to HV, HV/LV and EHV network levels. They felt that DCP 094 proposes to address this defect by introducing a different defect - removing these costs altogether. The respondent argued that it has not been demonstrated by the Working Group that this exchange of defects represents an improvement on the methodology as it currently exists both in terms of better facilitating competition or better cost reflectivity. It was also stated that they consider that the very tightly worded intent of the DCP 094 has in practice precluded the Working Group from considering any other alternatives.
- 4.5 One respondent also noted that there is insufficient detail within the source data to split between voltage levels, however they stated that they do not believe that the Working Group has shown that the suggested change is an improvement and provides better cost reflectivity than current practice.
- 4.6 The other area in which there were contrary comments to the agreement of the majority of the group was in regard to whether they believe that the intent of DCP 094 is adequately met, or whether there are alternative ways of meeting the intent of DCP 094.
- 4.7 One respondent noted that an alternative approach to the identified defect would be to examine ways of improving the values underlying the weighing/split values and to model this case within Model M accordingly. However, they felt they were not able to suggest this during the RFI as the very tightly worded intent of the CP does in practice preclude any

alternative from being considered by the Working Group.

- 4.8 Another respondent felt that the intent of DCP094 was very narrow and an alternative approach would be to further examine the source data, but again felt that the consideration of an alternative would have been precluded.
- 4.9 The Working Group discussed these comments during the meeting. It was confirmed by the proposer of DCP 094 that the intent was intentionally written to have a narrow scope. This would ensure that the option that is set out in the CP itself is the one which the Working Group evaluates, and that the scope would not be broadened to consider other alternatives which diluted or compromised the intent. The proposer felt that the preliminary analysis sufficiently demonstrated the best option to take forward.
- 4.10 There were also various comments that addressed the governance of the Method M, as well as the cumulative effects of implementing the four CPs (DCP 094 – 097) which this working group reviewed. These comments were discussed and deemed to be outside the scope of the Working Group.
- 4.11 One respondent felt that there was a possibility that there could be material impacts on Suppliers in the future, and therefore should be given the opportunity to vote and comment on the Change Proposal. The proposer did not feel that there was an immediate impact on Suppliers, however to address this point, it was agreed to give Suppliers the opportunity to vote on DCP 094.
- 4.12 A complete and detailed summary of all Party responses are set out in Appendix B.

5 PROPOSED LEGAL DRAFTING

- 5.1 The proposed legal drafting of DCP 094 has been drafted by the Working Group, and reviewed by Wragge and Co, and is attached as Appendix A.

6 EVALUATION AGAINST THE DCUSA AND CHARGING OBJECTIVES

- 6.1 The Working Group considered the consultation responses regarding whether DCP 094 better facilitated each DCUSA General and CDCM Objectives. There were seven responses to the Consultation and 5 agreed with the CP better facilitating the relevant objectives and 2 did not. The full set of Consultation responses is attached as Appendix B.

- 6.2 Following the Consultation responses, the Working Group was not able to reach a consensus in agreeing that the DCUSA General Objectives were better facilitated by this Change Proposal. Whilst the majority of the Working Group felt that following DCUSA General Objectives were better facilitated, there were members who did not agree:
- Objective 2² – Better Facilitated - The facilitation of effective competition in the generation and supply of electricity and (so far as is consistent with that) the promotion of such competition in the sale, distribution and purchase of electricity.
- 6.3 The majority of the Working Group considers that Objective 2 is better facilitated because DCP094 removes distortions in the allocation of costs incurred by DNOs and as a consequence improves the cost reflectivity brought about by the change will better promote competition in distribution. This is because current allocation of '*Load related new connections & reinforcement (net of contributions)*' does not reflect what the net costs incurred at each tier are and as a consequence unduly skews the calculation of the weighted average percentage costs towards higher network tiers. This in turn distorts the calculation of the discount factors used to LDNO tariffs reducing the net margins available to LDNOs.
- 6.4 Such distortions may result in margin squeeze and result in an LDNO that is at least as efficient as the DNO to be able to operate the network on the same basis as the DNO and earn a margin. This will ultimately lead to foreclosure of the market for LDNOs.
- 6.5 Removing these costs from all network levels is more cost reflective than the current methodology because it corrects the artificial and incorrect weighting of direct costs to the HV, HV/LV and EHV network levels. Furthermore, this is achieved without significant disturbance to the overall cost incurred by DNOs as the total cost in this category when summed over all network levels is negligible in comparison to the total costs recorded in the RRP by DNOs.
- 6.6 An alternative approach would be to accurately allocate costs and contributions to the relevant network tiers. However, whilst such an approach may be better than the proposed CP, the information to accurately

² The facilitation of effective competition in the generation and supply of electricity and (so far as is consistent therewith) the promotion of such competition in the sale, distribution and purchase of electricity

these costs may be readily available. Therefore, the Working Group recognises that CP is better than the current allocation method and therefore better meets DCUSA General Objective 2.

6.7 Following the Consultation responses, the Working Group was not able to reach a consensus in agreeing that the DCUSA CDCM Objectives were better facilitated by this Change Proposal. The majority of the Working Group, except two members, felt that following DCUSA CDCM Objectives were better facilitated:

- Objective 2³ – Better Facilitated – Will result in improved cost reflectivity and will aid the facilitation of competition.
- Objective 3⁴ – Better facilitated - The CP will improve cost reflectivity.

6.8 The majority of the working group considered that under DCP 094 DCUSA CDCM Objective 2 will be better facilitated as the CP will enhance cost reflectivity, thereby reducing distortion in the allocation of costs between competitors in the distribution of electricity.

6.9 The majority of the Working Group considers that under DCP 094 DCUSA CDCM Objective 3 will be better facilitated as the CP will improve cost reflectivity, as detailed above.

6.10 A complete and detailed summary of all the Party responses are set out in Appendix B.

7 IMPLEMENTATION

7.1 DCP 094 is classified as a Part 1 matter in accordance to Clause 9.4.2 (B) of the Agreement, and therefore will go to the Authority for determination after the voting process has completed.

7.2 The implementation date, subject to Authority approval, would be 01 April 2012.

7.3 The outcome of DCP094 will be known by early December 2011, allowing

3 That compliance by each DNO Party with the Charging Methodologies facilitates competition in the generation and supply of electricity and will not restrict, distort, or prevent competition in the transmission or distribution of electricity or in participation in the operation of an Interconnector (as defined in the Distribution Licences)

4 That compliance by each DNO Party with the Charging Methodologies results in charges which, so far as is reasonably practicable after taking account of implementation costs, reflect the costs incurred, or reasonably expected to be incurred, by the DNO Party in its Distribution Business

Distributors to take the proposal into account when publishing their indicative charges in December 2011 and final prices in February 2012 for implementation from 01 April 2012.

8 ENGAGEMENT WITH THE AUTHORITY

- 8.1 Ofgem has been fully engaged throughout the development of DCP 094 as a member of the Working Group.

9 PANEL RECOMMENDATION

- 9.1 The Panel approved this Change Report by ex-Committee on 13 October 2011. The Panel considered that the Working Group had carried out the level of analysis required to enable Parties to understand the impact of the proposed amendment and to vote on DCP 094.
- 9.2 The timetable for the progression of the Change Proposals is set out below:

Activity	Date
Change Report issued for voting	14 October 2011
Voting closes	28 October 2011
Change Declaration	01 November 2011
Authority Determination	06 December 2011
CP Implemented	01 April 2012

10 APPENDICES:

Appendix A - DCP 094 - Legal Drafting

Appendix B - DCP 094 – Consultation Documents and Working Group Comments

Appendix C - DCP 094 - Voting Form