

Proposed variation:	Distribution Connection and Use of System Agreement (DCUSA) DCP088: Mid-year CDCM Charging Model		
Decision:	The Authority ¹ has decided to reject DCP088 ²		
Target audience:	DCUSA Panel, parties to the DCUSA and other interested parties		
Date of publication:	11 July 2012	Implementation Date:	N/A

Background to the modification proposal

The price control framework³ is embodied in several charge restriction conditions (CRCs) and standard licence conditions (SLCs) of the Electricity Distribution Licence (the licence). The CRCs prescribe revenue allowances and how the revenue allowances may be adjusted for a range of factors, including a company's performance under various incentive mechanisms. The CRCs also set out obligations on Distribution Network Operators (DNOs), including the setting of Distribution Use of System (DUoS) charges in a way that is consistent with their revenue allowance.

As a result of our decision on DCUSA change proposal DCP001⁴, clause 19.1 of the DCUSA provides that DNOs and Independent Distribution Network Operators (IDNOs) must use reasonable endeavours not to vary their DUoS charges more than two times a year, on 1 April and 1 October (mid-year). In addition, the licence places an obligation on DNOs to provide three months' notice of changes to charges.⁵

The joint effect of the licence obligation and the DCUSA obligation is that, although DNOs and IDNOs are encouraged only to change their charges on the two specified dates, they can still make changes to their charges on another date provided that three months' notice is given.

Paragraph three of the Common Distribution Charging Methodology (CDCM) requires DNOs to populate and publish the CDCM model when setting DUoS charges. The current version of the CDCM model (version 100 – published on 1 April 2010) is designed to determine tariffs that will apply to a full financial year only. Mid-year tariff changes have occurred using this model but the DCUSA does not spell out how these should be addressed.

The modification proposal

DCP088 was raised by Scottish Power Energy Networks (the proposer) in March 2011. The change proposal is to amend the DCUSA by making transparent how the methodology should be applied when considering a mid-year change in tariffs. It also addresses an issue of non-zero values being displayed as blank cells in the tariff worksheet within the CDCM model.

The proposer expected that this change proposal would amend the CDCM model (which forms part of the CDCM) and did not expect that it would require Schedule 16 of the DCUSA (the CDCM) to be amended (other than to change paragraph 3 to the next version number of the CDCM model). The proposer considered that the proposed changes would better facilitate the achievement of DCUSA Charging Objectives 3.2.1 and 3.2.2.⁶

They explained that while it was possible to use the existing version of the model (version 100) for a mid-year tariff change, it requires the allowed revenue figure to be adjusted to take

¹ The terms 'the Authority', 'Ofgem' and 'we' are used interchangeably in this document. Ofgem is the Office of the Gas and Electricity Markets Authority.

² This document is notice of the reasons for this decision as required by section 49A of the Electricity Act 1989.

³ DPCR5 is the current price control (2010–2015). Details about the price control are available on the Ofgem website.

⁴ DCP001 Alternative was implemented on 1 November 2007. The Authority's decision is available on the Ofgem website:

<http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=2&refer=Licensing/ElecCodes/DCUSA/Changes>.

⁵ The requirement to give three months notice is set out in SLC 14.11 of the licence.

⁶ Applicable Charging Objective 3.2.1 is that that compliance by each DNO Party with the Charging Methodologies facilitates the discharge by the DNO Party of the obligations imposed on it under the Act and by its Distribution Licence. Applicable Charging Objective 3.2.2 is 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 licence).

account of the revenue to be recovered in the periods before and after the price change. They considered that this was complicated and that it impaired the transparency of the CDCM. In the proposer's view, the change proposal would enable the input of data for mid-year tariffs to be clear and transparent for all parties. They considered that it would aid the understanding of changes between current charges and new proposed charges. In addition, they considered that the proposed changes would enable the model to be published with all the relevant data to help parties understand the changes.

A Working Group was established to assess the proposal and to develop a solution. The Working Group considered that more changes to the CDCM were required than were originally anticipated to reflect changes made in the model to address explicitly a mid-year tariff change.

The changes to the CDCM originally proposed by the Working Group⁷ are as follows -

- Replaced the defined term 'charging year' with 'charging period'. Both terms were defined as 'the period ending on 31 March of the regulatory year for which the charges and credits are being calculated'.
- Introduced the term 'regulatory year' which was defined as 'the 12-month period ending on 31 March for which charges and credits are being calculated.'
- Used the newly defined terms "charging period" and "regulatory year" throughout the text to set out the period(s) that should be considered when analysing/allocating costs.
- Updated clause 89 of DCUSA, so that DNOs estimate relevant revenues for the regulatory year by:
 - (a) summing the forecast of volumes multiplied by tariff components for the current charging period⁸;
 - (b) adding the revenue for previous charging periods as estimated by the DNO (which may include reconciliation for prior years); and
 - (c) excluding any revenues treated as excluded revenue under the price control conditions.

The Working Group amended the model to allow for mid-year price changes.⁹ The CDCM model developed by the DCP088 Working Group is published alongside this decision (Annex A).

The Working Group issued a consultation to suppliers, DNOs, IDNOs and consumers on 16 February 2012 to determine whether parties understood and supported the intent of DCP088. It also asked for views on any alternative solutions or issues that should be considered and also sought to understand parties' experiences of testing the revised model. Finally, it asked for any specific comments on the proposed CDCM drafting.

All respondents to the consultation indicated that they understood the intent of the proposal and supported the proposed solution. Respondents to the consultation were split on which of the DCUSA Charging Objectives were better facilitated by the proposal. The detailed views of the Working Group (including their evaluation of the proposal against the DCUSA Charging Objectives) and other parties are provided in the Change Report.

In light of a number of formatting errors in the legal text and the model that were identified at consultation, both the legal text and the model were updated before the DCP088 Change Declaration was issued. Changes to the model corrected the formatting issues identified. The following changes were made to the CDCM drafting -

- Introduction of the term 'tariff applicability period' which is defined in the text as meaning: "the relevant charging year, or (in the case of tariff changes part way through the charging year) either (as the context requires): (a) the remaining period of the charging year from

⁷ Note that the changes originally proposed by the Working Group and consulted on by the Working Group differ from those actually proposed by the Change Report later issued by the Working Group.

⁸ 'where the tariff components for the charging period being calculated are those derived from step 2' - (Step 2 is set out at the legal text reproduced at Annex B).

⁹ The consultant's report describing the differences between the CDCM model 100 issued by DCUSA in 2010 and the CDCM model developed by the DCP088 Working Group was published alongside the Working Group's consultation.

which the revised tariffs are to apply; or (b) each of the successive periods from the start of the charging year until that (or a previous) tariff change”.

- Use of the term ‘tariff applicability period’ in place of originally proposed terms ‘charging period’ and ‘regulatory year’ (other than at paragraph 42 where the text references the ‘charging year’).
- An updated clause 89, so that DNOs estimate relevant revenues for the regulatory year by:
 - summing the forecast of volumes multiplied by tariff components for the current tariff applicability period¹⁰;
 - adding the revenue for previous tariff applicability periods as estimated by the DNO (which may include reconciliation for prior years); and
 - excluding any revenues treated as excluded revenue under the price control conditions.

A copy of the proposed CDCM drafting is published alongside this decision as Annex B.

DCUSA Parties’ recommendation

The DCP088 Change Declaration indicates that DNO, IDNO/Offshore Transmission System Operator (OTSO), supplier and Distributed Generation (DG)¹¹ parties were eligible to vote on DCP088. As shown in the table below, the sum of the weighted votes in favour of the proposal was greater than 50 per cent in all categories that voted. In accordance with the weighted vote procedure, the recommendation to us is that DCP088 be accepted. The outcome of the weighted vote is set out in the table below:

DCP 088	DNO		IDNO/OTSO		SUPPLIER	
	Accept	Reject	Accept	Reject	Accept	Reject
CHANGE SOLUTION %	100	0	100	0	80	20
IMPLEMENTATION DATE %	72	28	75	25	100	0

However, when parties voted on whether to accept the change proposal, British Gas raised concerns that, in its view, there were errors in the proposed changes to the CDCM. It considered that, in a number of places, in the case of a mid-year tariff change, the CDCM text referred only to part of the charging year (either post the mid-year change or prior to the mid-year change) when it considered it should refer to the full charging year. British Gas voted to reject the change proposal on this basis.

The Authority’s decision

We have considered the issues raised by the proposal and the Change Declaration of 7 June 2012. We have taken into account the vote of the DCUSA Parties on the proposal, which is set out in the Change Declaration. We have also considered and taken into account the responses to the Working Group’s¹² consultation, which are attached to the Change Report.

We have concluded that implementation of change proposal DCP088 will not better facilitate the achievement of the DCUSA Charging Objectives.¹³

¹⁰ Where the tariff components for the charging period being calculated are those derived from step 2’ - (Step 2 is set out at the legal text reproduced at Annex B).

¹¹ No votes were cast in the DG category.

¹² In accordance with the role, functions, and responsibilities of the Working Group set out in Section 1B of the DCUSA.

¹³ The DCUSA Charging Objectives (Applicable Charging Methodology Objectives) are set out in Part B of Standard Licence Condition 22A of the Electricity Distribution Licence and are also set out in Clause 3.2 of the DCUSA.

Reasons for the Authority's decision

This section sets out our views on relevant wider issues pertinent to this decision. It also sets out our reasons for rejecting the change proposal against the DCUSA Charging Objectives which, in our view, are relevant to our decision.

We raised with DNOs British Gas's concerns about the legal text. We understand that, in some circumstances, for example paragraph 54 of the proposed CDCM text¹⁴, DNOs have differing views as to whether the proposed changes to the CDCM require them to consider only part of the relevant charging year (either the period before or after the mid-year tariff change), or the full relevant charging year, when forecasting volumes and analysing costs in the event of a mid-year price change. This demonstrates that the proposed drafting is unclear even to the experts within industry.

We consider that, in the event of a mid-year tariff change, the newly defined term 'tariff applicability period' can only ever mean part of the charging year.¹⁵ Therefore, we consider that all instances of the term 'tariff applicability period' in the proposed changes to the CDCM require DNOs to consider only part of the relevant charging year when there is a mid-year tariff change.

We are concerned that, if we were to approve the change proposal, confusion amongst DNOs as to what periods should be considered when setting tariffs in the event of a mid-year price change would make it difficult for DNOs to implement mid-year price changes in a consistent manner. We are also concerned that the changes proposed to the CDCM are not consistent with the changes proposed to the CDCM model which, we consider in some instances refers to the full relevant charging year in the event of a mid-year price change where the legal drafting does not.

DCUSA Charging Objective 3.2.1 'that compliance with the Charging Methodologies facilitates the discharge by the DNO party of the obligations imposed on it under the Act and by its Distribution Licence'

The DCUSA Working Group concluded that the change proposal would better facilitate this objective because it considered that it would provide greater transparency and more effective discharge of licence obligations in the event of mid-year tariff changes.

For the reasons outlined above, we do not agree with this view. Whilst we support the intent of the change proposal, we do not consider that the changes currently proposed to the CDCM text will allow DNOs to discharge their obligations under the Distribution Licence. In particular, we are concerned that the proposal could result in DNOs setting charges that are not consistent with their revenue allowance, i.e. that they could prevent compliance with Charge Restriction Condition 3.2 (CRC 3.2) of the Distribution Licence.¹⁶

We do not therefore consider that the proposal better facilitates Charging Objective 3.2.1.

DCUSA Charging Objective 3.2.2 'that compliance 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'

¹⁴ Paragraph 54 of the proposed CDCM text states that 'The DNO Party prepares a forecast of allowed revenue for the tariff applicability period in accordance with the requirements of, the price control conditions and in a manner which is consistent with its volume forecasts'.

¹⁵ Either a) the remaining period of the charging year from which the revised tariffs are to apply or b) each of the successive periods from the start of the charging year until that (or a previous tariff change).

¹⁶ CRC3.2 requires licensees to take all appropriate steps, in setting DUoS charges, to ensure that Regulated Combined Distribution Network Revenue does not exceed Combined Allowed Distribution Network Revenue in a given regulatory year.

The DCUSA Working Group concluded that the change proposal would better facilitate this objective because it considered that it would provide greater transparency and additional information which would in turn facilitate competition.

For the reasons outlined above, we do not agree with this view. Whilst we support the intent of this change proposal, we consider that the apparent disconnect between the CDCM text and the model could result in suppliers having less clarity over the impact of mid-year tariff changes. We do not consider that the proposal would better facilitate competition as a result.

We do not therefore consider that the proposal better facilitates Charging Objective 3.2.2.

DCUSA Charging Objective 3.2.3 'that compliance with the Charging Methodologies results in charges that, so far as is reasonably practicable after taking account of implementation costs, reflect the costs incurred, or reasonably expected to be incurred, by a Distribution Services Provider in its Distribution Business'

The DCUSA Working Group concluded that the change proposal would better facilitate this objective because it would make it possible for DNOs to implement mid-year price changes in a consistent and visible manner.

For the reasons outlined above, we do not agree with this view. Whilst we support the intent of the change proposal, we are concerned that the changes currently proposed to the CDCM text could result in DNOs setting charges that are inconsistent with their revenue allowance, i.e. the costs incurred or reasonably expected to be incurred in their Distribution Business.

We do not therefore consider that the proposal better facilitates Charging Objective 3.2.3.

DCUSA parties' vote

We note that, in places, the Change Report issued on 18 May 2012 included references to outdated versions of the changes proposed to the CDCM and that, as a result, all voting parties may not have realised that the change proposal had been amended following the Working Group consultation.¹⁷

We are concerned that the DNOs did not ensure that they had a full and consistent understanding of the changes proposed by DCP088 prior to voting to accept the change proposal. Furthermore, we are concerned that DNOs voted to accept the change proposal when later discussions have indicated that they do not always agree with the proposed changes to the CDCM (i.e. in some instances they consider that references to part of the relevant charging year (in the event of a mid-year tariff change) should in fact be references to the full relevant charging year).

In future, we expect DNOs and other DCUSA parties to consider fully the final change proposal ahead of voting, particularly when there are changes to the legal text following the Working Group process. We consider that DCP088 would have been a beneficial modification but for the late changes to the legal text which made the interpretation unclear, introduced inconsistency between the model and the legal text, and in some areas introduced errors into how the methodology should be applied for a mid-year price change. We encourage DNOs to raise another modification in a timely manner to address this issue and to ensure that a robust approach is taken to addressing our concerns on legal text drafting for all current and future change proposals to avoid similar issues arising again.

Andy Burgess

Associate Partner, Transmission and Distribution Policy

Signed on behalf of the Authority and authorised for that purpose

¹⁷ The reference to paragraph 89 of the CDCM refers to a previous version of the drafting issued alongside the DCP088 consultation, ie it does not feature the term 'Tariff Applicability Period'.