Making a positive difference for energy consumers

Proposed modification:	**Distribution Connection and Use of System Agreement (DCUSA) DCP161 – Excess capacity charges**
Decision:	The Authority[1] directs that modification DCP161 be made[2]
Target audience:	DCUSA Panel, Parties to the DCUSA and other interested parties
Date of publication:	15 October 2014 / Implementation Date: 1 April 2016

Summary

We have decided to direct that this modification to DCUSA is made, for the reasons given in this document. The Common Distribution Charging Methodology (CDCM) currently allows discounts for customer contributions towards reinforcement work that are made at the time of connection. These discounts are applied to both capacity charges (charges for contracted capacity levels) and excess capacity charges (charges for using more than contracted capacity). This means that the discount is currently applied in circumstances in which customers have not made a capital contribution towards reinforcement costs beyond their contracted capacities. We consider that the removal of this excess capacity charge discount results in charges that are more cost reflective.

Background

The CDCM and the EHV Distribution Charging Methodology (EDCM) both include capacity charges (pence/kVA/day[3]) that apply to customers' agreed Maximum Import Capacities (MICs)[4]. For CDCM customers, this capacity charge can be discounted to reflect customer contributions towards reinforcing the network at the time of connection. The upfront contributions relate to the same costs as the capacity charge, ie further reinforcement for contracted capacity use. If the agreed MIC is breached, the customer incurs a further charge (ie an 'excess capacity charge'). This is currently imposed at the same rate as the MIC charge and includes the discount where applicable. The two differences are that:

- as the excess of capacity was not expected, and not contracted for, the upfront contribution was not intended to relate to this; and
- rather than being applied for the year, excess capacity charges are only imposed for the month in which the breach occurred.

The proposer of this DCUSA change proposal (DCP) considers that the current arrangement is not cost reflective. Using the existing excess capacity charge for exceeding the MIC means that this discount is also applied to a capacity for which no customer contribution has been made. Furthermore, the MIC charge is applied for the full charging year but the excess capacity charge is only applied for the month of the breach. The effective excess capacity rate across a full charging year will therefore be less than the rate paid for the existing capacity (except where the MIC is breached by the same amount in every month of the year). The proposer considers that this can create a perverse inventive for customers to avoid contracting for the capacity they require.

The modification proposal

DCP161 was raised by Electricity North West Limited on 6 February 2013. It proposes to remove the discount on excess capacity charges so that the remaining discount (on

[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] Although charged on the basis of pence/kVA (kilovolt-ampere)/day the charge applies throughout the year in accordance with the customer's agreed Maximum Import Capacity (MIC) in the customer's connection agreement.
[4] The MIC is the maximum capacity the customer agrees to abide by in its connection agreement.

capacity charges) is equivalent to the upfront contribution and to avoid the risk of a perverse incentive.

The modification was developed and consulted on by the DCUSA working group. Their first consultation examined a variety of options to make the overall change as cost reflective as possible. These included charging excess capacity on a seasonal or time of day basis, using scaling factors effectively to recover charges on an annual basis, and imposing the excess capacity for the full charging year. Based upon the consultation responses[5] and, after due consideration, the working group proposed an option they considered simpler. They proposed removing the discount from the excess capacity charge for CDCM customers and leaving all other aspects unchanged. This would not apply to export capacity[6] or EDCM customers[7]. In addition, it would not involve any changes to the way the charge is imposed - the charge would only apply to the month in which a breach occurs. This proposal was the subject of the second consultation.

The responses to this second consultation were mixed. In general, the DNOs and the Independent Network Distribution Operators (IDNOs) believed that the proposal was an improvement on the status quo by being more cost reflective. However, some also felt that it did not go far enough. This was because only imposing the excess charge for one month still gives customers an incentive to seek a MIC which is lower than required. Some suppliers, on the other hand, considered that the removal of the discount on the excess capacity charge was a penalty charge. This is because it had not been proved that a customer exceeding its MIC generates additional costs for the DNO.

The DCUSA Change Report states that the proposal better facilitates DCUSA general objectives 3.1.1 and 3.1.3, and charging objectives 3.2.3 and 3.2.4. It states that the removal of the discount on the excess capacity charge is more cost reflective. This will encourage customers to seek MICs which will meet their requirements. This, in turn, will assist with planning by providing greater certainty of future load requirements. However, the report, the consultation responses and the change declaration also included statements from various parties who disagreed and/or felt that such statements were unproven.

The impact analysis comprised a schedule of tariffs and revenues with and without the change. The DNOs also provided historical data on the number of customers that have exceeded their capacity (and those subject to capacity charges), revenues received from excess capacity charges, and the number of invoices for excess capacity. One DNO presented a case study suggesting how exceeded capacity by one customer could trigger reinforcement. This case study was challenged on the grounds that the proposal provided no financial incentive for the customer to seek a higher MIC. Although the industry has submitted evidence on the degree to which excess capacity is being used, we consider that it does not provide adequate evidence of any consequential additional costs incurred by the DNOs.

The working group proposed an implementation date of 1 April 2016 to enable customers to have time to respond to this change and to minimise the number of customers affected by mid-contract changes.

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[5] The consultation responses generally supported the intent of the proposals but recognised that there were many counter arguments on each of the proposed options and reaching agreement as to a proposed solution from these four options was unlikely.

[6] Generation does not currently incur an export capacity charge and exceeding the Maximum Export Capacity does not have the same connotations on the network as does exceeding the MIC.

[7] The calculation of the excess capacity charge within the EDCM did not need to be amended as it already excluded customer contributions.

DCUSA Parties' recommendation

The Change Declaration for DCP161 indicates that all parties were eligible to vote. In each party category where votes were cast (no votes were cast in the distributed generation (DG) and gas supplier categories), there was a majority of support from DNOs and unanimous support from IDNOs/ Offshore Transmission System Operators (IDNO/OTSOs) for the proposal. A majority of suppliers voted to reject. In accordance with the weighted vote procedure, the recommendation to us is that the DCP161 change solution and its proposed implementation date are rejected. The outcome of the weighted vote is set out in the table below:

DCP161	Weighted voting (%)									
	DNO		IDNO/ OTSO		Supplier		DG[8]		Gas supplier[9]	
	A	R	A	R	A	R	A	R	A	R
Change solution	87	13	100	0	17	83	n/a	n/a	n/a	n/a
Implementation date	87	13	100	0	17	83	n/a	n/a	n/a	n/a

Our decision

We have considered the issues raised by the proposal and the Change Declaration dated 10 September 2014. We have considered and taken into account the vote of the DCUSA Parties on the proposal attached to the Change Declaration. We have concluded that:

- implementation of the change proposal DCP161 will facilitate better the achievement of the DCUSA Charging Objectives;[10] and
- directing that the change is approved is consistent with our principal objective and statutory duties.[11]

Reasons for the Authority's decision

We consider this proposal will better facilitate DCUSA Charging Objective 3.2.3 and has a neutral impact on the other objectives.

DCUSA Charging Objective 3.2.3 – 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

We have considered the arguments in relation to this charging objective. We consider that DNOs could at times incur additional costs resulting from the use of excess capacity. However, the costs recovered through the upfront contribution are equivalent to the discount on capacity charges rather than a discount on both capacity and excess capacity charges. Where customers make a capital contribution to reinforcement to meet their agreed import capacities (but not beyond) they are provided with a discount on the capacity charge to reflect this contribution. These customers, however, have not made a contribution to a capacity in excess of this MIC.

[8] No votes were cast in this category of Parties
[9] No votes were cast in this category of Parties
[10] The Applicable Charging Methodology Objectives (Charging Objectives) are set out in Standard Licence Condition 22A Part B of the Electricity Distribution Licence and are also set out in Clause 3.2 of the DCUSA.
[11] The Authority's statutory duties are wider than matters that the Panel must take into consideration and are detailed mainly in the Electricity Act 1989 as amended.

We have considered the impact on customers who remain within their MIC. These and all other customers are effectively cross subsidising those who exceed their MIC but do not pay the full undiscounted capacity charge. The impact analysis shows that the increase in excess capacity charges resulting from this proposal results in very small reductions in charges for most other customers.

We agree with the concerns raised that this proposal could be more cost reflective if the excess capacity charge endured for the whole charging year. Imposing the excess capacity charge only for the month of the breach limits the effectiveness of the price signals it sends. This is because it may be better for a customer to accept excess capacity charges for part of a year than to increase the MIC which would add to charges for the whole year. We recognise that the working group examined an option to impose the excess capacity charge over a year but was dropped on the basis that it could unfairly affect those customers who inadvertently and/or occasionally exceeded their MIC.

In the round, we consider that, although the benefits of this proposal are limited, this proposal meets this charging objective better as it results in more cost reflective charges.

DCUSA Charging Objective 3.2.4 – that, so far as is consistent with Clauses 3.2.1 to 3.2.3, the Charging Methodologies, so far as is reasonably practicable, properly take account of developments in each DNO Party's Distribution Business

The working group considered that applying more cost reflective excess capacity charges as proposed would incentivise customers to use their existing capacity more efficiently. This would, in turn, lead to more efficient network costs for the benefit of all customers. The group also considered that this proposal would incentivise greater use of demand side response activities. This point was challenged, however, on the basis that it is not a legitimate objective of the charging methodology to help DNOs reduce reinforcement costs by discouraging customers from using capacity on the network. Although we agree that more efficient use of capacity is beneficial we are not convinced that the price signals resulting from this proposal are strong enough to deliver any material behaviour change from customers. Consequently, we are not convinced that this proposal will have a material impact on network costs, and reinforcement costs in particular. We consider that this proposal has a neutral impact on this charging objective.

Decision notice

In accordance with standard licence condition 22.14 of the Electricity Distribution Licence, the Authority hereby directs that modification proposal DCP161: *'Excess capacity charges'* be made.

Andrew Burgess
Associate Partner, Transmission and Distribution Policy
Signed on behalf of the Authority and authorised for that purpose