

Proposed variation:	Distribution Connection and Use of System Agreement (DCUSA) DCP178 – Notification period for change to use of system charges		
Decision:	The Authority ¹ directs this modification ² be made ³		
Target audience:	DCUSA Panel, Parties to the DCUSA and other interested parties		
Date of publication:	24 February 2015	Implementation date:	5 November 2015

Background

Distribution network operators (DNOs) are required under DCUSA to publish final distribution use of system (DUoS) charges for the forthcoming year (1 April – 31 March) 40 days before it starts. Suppliers have argued that this does not give them enough notice and that they price the uncertainty about charges into the risk premium in their contracts. Some large customers have also indicated that 40 days' notice is too late for them to reflect DUoS charges accurately in their budgets for the upcoming financial year.

The modification proposal

DCP178 was proposed by Northern Powergrid and seeks to extend the notice period for DUoS charges to 15 months. The basis for this timeframe was that it was the most logical extension of the notification period (ie one year more than the three month notice period for interim charges under the electricity distribution licence). These would be final charges. Parties would need to seek a derogation from us in order to change them beyond this date. As well as DUoS charges, the 15-month notice period would apply to the DNOs' other charging statements for meter point administration services, legacy meter asset protection, last resort payments and other miscellaneous charges.

Independent distribution network operators (IDNOs) would be required to give 14 months' notice of charges. This is because IDNOs need to receive notice of the DNOs' charges before they can finalise their own charges.

DCUSA Parties' recommendation

The Change Declaration for DCP178 indicates that all parties were eligible to vote on DCP178. Of the party categories where votes were cast (no votes were cast in the DG⁴ or gas supplier⁵ categories), there was majority support for the proposal from DNOs and suppliers but not for the proposed implementation date of 5 November 2015. The IDNO/OTSO parties who voted rejected both the proposal and the implementation date. In accordance with the weighted vote procedure, the recommendation to us is that DCP178 is rejected. The outcome of the weighted vote is set out in the table below:

DCP178	WEIGHTED VOTING (%)					
	DNO ⁶		IDNO/OTSO ⁷		SUPPLIER	
	Accept	Reject	Accept	Reject	Accept	Reject
CHANGE SOLUTION	69	31	0	100	100	0
IMPLEMENTATION DATE	40	60	0	100	100	0

¹ References to the "Authority", "Ofgem", "we" and "our" are used interchangeably in this document. The Authority refers to GEMA, the Gas and Electricity Markets Authority. The Office of Gas and Electricity Markets (Ofgem) supports GEMA in its day to day work. This decision is made by or on behalf of GEMA.

² 'Change' and 'modification' are used interchangeably in this document.

³ This document is notice of the reasons for this decision as required by section 49A of the Electricity Act 1989.

⁴ Distributed Generation

⁵ There are currently no gas supplier parties

⁶ Distribution Network Operator

⁷ Independent Distribution Network Operator/Offshore Transmission System Operator

Our consultation

On 8 August 2014, we consulted⁸ with stakeholders to provide a further opportunity for them to raise any remaining issues and any evidence of the effects on their businesses. Respondents to our consultation identified a number of potential benefits and costs. These include -

- Advanced notice of charges should enable suppliers to reduce the risk premium they currently price into contracts with customers.
- Suppliers may also be able to offer a wider range of products, such as non-pass through contracts to large customers.
- The proposal transfers forecasting risk from suppliers to DNOs. Some parties consider that this is appropriate, as they believe the risk is better managed by the regulated businesses.
- The proposal increases predictability of charges but does not address underlying volatility and may actually increase the size of step changes between years. It would be better to address the volatility in the model. Supporters argue that increased predictability of charges is still an improvement, as the change will be known in advance and can be budgeted for.
- DNOs will not know their final allowed revenue when they set their prices, which may increase their risk of over or under recovering and incurring a penalty.
- IDNOs earn revenue from the margin between DNOs' charges and their own. If we were to approve a modification which improves their margin, then the extended notice period under DCP178 would delay when IDNOs would start to receive that benefit.

Send back decision

On 24 October 2014 we sent the proposal back to the DCUSA Panel. While we recognised it was a finely balanced decision, we said that we were minded to accept DCP178. However, we did not consider the proposed implementation date (5 November 2014) to be feasible or desirable, as it would mean the DNOs would have had to provide final charging statements for 2016-17 by 31 December 2014 when there was still a significant amount of uncertainty around final revenues. We asked the Panel to work with the industry to determine an appropriate implementation date. The revised proposal was issued to the industry for voting on 18 December 2014. There were no material changes to the proposal except for the implementation date.

On 20 January 2015, we were sent a new change declaration with a new proposed implementation date of 5 November 2015.

Our decision

We have considered the issues raised in the proposal, responses to our consultation, the Change Report and the Change Declaration dated 20 January 2015. We have also considered and taken into account the vote of the DCUSA Parties on the proposal which is attached to the Change Declaration. We have concluded that:

- implementation of the modification proposal will better facilitate the achievement of the DCUSA Charging Objectives;⁹ and

⁸ <https://www.ofgem.gov.uk/publications-and-updates/consultation-proposal-increase-significantly-notification-period-changes-distribution-use-system-charges>

⁹ The DCUSA Charging Objectives (Relevant 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.

- directing that the modification be made is consistent with our principal objective and statutory duties.¹⁰

Reasons for our decision

We consider this modification proposal will better facilitate DCUSA Charging Objective 3.2.2 but may have a detrimental impact on Charging Objective 3.2.3. We consider the proposal to be neutral in terms of the other charging objectives. While there is some uncertainty as to whether suppliers will fully pass on the benefits of the increased notice period, on balance, we consider the proposal better facilitates the relevant objectives.

DCUSA Charging Objective 3.2.2 – 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)

The working group considered that DCP178 facilitated this charging objective better by increasing stability and transparency, which should encourage competition by reducing price shocks for suppliers and consumers.

Some parties argued that the proposal would actually prevent or distort competition by reducing cost reflectivity. In particular IDNO parties highlighted that the delay in implementation of new modifications might have an impact on their margins and extend the time some customers continued to benefit, while others paid higher charges. We note that there is at least one modification¹¹ at the working group stage that, if approved, would impact on how IDNO margins are calculated. However, we expect that a decision on this modification will be made before the November implementation date for DCP178. Although no other modifications have been identified to date, if any significant adverse effects on IDNOs arise, we are open to discussing the options available with industry.

One DNO party suggested that DCP178 would particularly affect customers connected at extra high voltages, as their charges are based on their actual network usage. DCP178 will increase the lag between a customer's usage and the time it is reflected in their charges. While we recognise this potential impact of the proposal, we note that the large customers who responded to both the working group and our consultations supported the increased notice period and believed it would be beneficial to their businesses.

We have considered the responses from parties and consider that, on balance, the charging objective is facilitated better. Suppliers have lobbied publicly for this change and have argued that this will benefit retail customers. We therefore expect suppliers to reflect the benefit of advanced notice of charges in reduced risk premiums and more flexible contracts for larger customers. We also note that reduced risk premiums should benefit smaller suppliers, as it reduces the amount they need to finance as they potentially face a higher cost of capital than large suppliers. Finally, also consider that greater certainty of charges will be especially beneficial for customers connected at higher voltages who currently experience significant movements in their charges, as a result of factors beyond their control.

¹⁰ The Authority's statutory duties are wider than matters that the Parties must take into consideration and are detailed mainly in the Electricity Act 1989 as amended.

¹¹ DCP117 – Treatment of 'load related new connections and reinforcement (net of contributions)' in the Price Control Disaggregation Model

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

Some respondents to our consultation said DCP178 would reduce charging cost reflectivity, as DNOs would have to set their final charges using forecast, rather than actual, allowed revenue. We recognise the proposal has the potential to reduce cost reflectivity of charges. However, we note that the charging objective requires that charges reflect the costs incurred, or reasonably expected to be incurred by the DNO party. Although the DNOs will have to base their final charges on estimated allowed revenue, these would still reflect the costs that they reasonably expect to incur. This would not be inconsistent with this charging objective. We consider that this is offset by the potential benefits to consumers which advanced notice of DUoS charges should provide.

Issues raised post-voting

Given the proposal has been in development for more than a year and the new legal text was circulated to industry parties for comment, we were disappointed that further issues were identified after the new legal text had been submitted to parties for voting. One DNO has identified the absence in the legal text of explicit provisions for DNOs operating outside their distribution service area (DSA). While we recognise that this could potentially have an impact on DNOs operating outside their DSA, we consider there is sufficient time for those affected to develop a solution before the implementation date of 5 November 2015.

Another DNO expressed concerns about the fact the 15 month notice period will also apply to their other charging statements (eg provision of last resort supply payments). However, we note that this was discussed in the change report (paragraph 9.6) and the view of the working group was that a DNO could apply to us to be able to make a change within the 15 month notice period, if required. If a party has other concerns about the extended notice periods applying to their other charging statements, they can raise a supplementary modification proposal to make further changes to the legal text.

There was concern was that there is no explicit guidance in the DNOs' charge restriction conditions (CRCs) on how to calculate the inflation rate two years in advance when calculating allowed revenue for setting charges. We do not consider that setting an inflation rate conflicts with the CRCs, but accept that parties may want to consider clarifying the arrangements at a later date.

Decision notice

In accordance with standard licence condition 22.14 of the Electricity Distribution Licence, the Authority hereby directs that modification proposal DCP178: *Notification Period for Change to Use of System Charges* be made.

Andrew Burgess

Associate Partner, Transmission and Distribution Policy

Signed on behalf of the Authority and authorised for that purpose