



## **DCUSA Consultation**

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### DCP 230– Rate of Return Enduring Solution

## **PURPOSE**

- 1.1 The Distribution Connection and Use of System Agreement (DCUSA) is a multi-party contract between electricity Distributors, electricity Suppliers and large Generators. Parties to the DCUSA can raise Change Proposals (CPs) to amend the Agreement with the consent of other Parties and (where applicable) the Authority.
- 1.2 This document is a consultation issued to all DCUSA Parties, interested third parties, and the Authority in accordance with Clause 11.14 of the DCUSA seeking industry views on DCP 230 'Rate of Return Enduring Solution' by Parties.
- 1.3 Parties are invited to consider the proposed legal drafting set out in Attachment 2 to this document and submit comments using the response form provided as Attachment 1 to [DCUSA@electralink.co.uk](mailto:DCUSA@electralink.co.uk) by **22 May 2015**.

## **2 DCP 230 'Rate of Return Enduring Solution'**

- 2.1 DCP 230 has been raised by Western Power Distribution and seeks to revise the legal text within the DCUSA for the 'Annuity Rate of Return' to equal the pre-tax real weighted average cost of capital set for each DNO.
- 2.2 The Proposer explains that it was identified in 2014 that the words then contained within the DCUSA for the 'Annuity Rate of Return' were aligned to the Distribution Price Control Review 5 (DPCR 5) Distribution Licence and were no longer applicable under the RIIO-ED1 Distribution Licence. DCP 217 'Rate of Return' was raised to address this issue within the short-term, and was subsequently approved on 1 December 2014 by the Authority, and was implemented into the DCUSA on 1 April 2015. However, an enduring solution is felt to still be required.

## **3 WORKING GROUP ASSESSMENT**

- 3.1 The DCUSA Panel has established a DCP 230 Working Group which consists of DNO, Supplier and Ofgem representatives.
- 3.2 The Working Group has developed the following formula which was used for the impact analysis:

- pre – tax cost of capital = (gearing assumption x CDE) + (1- gearing assumption)\*(post tax cost of equity/(1-Corporation Tax Rate))
- Where CDE (Cost of Corporate Debt) is the latest CDE value for the licensee, directed by the Authority for use in the Annual Iteration Process for the ED1 Price Control Financial Model (or the opening value for CDE contained in the PCFM if no direction has been made at the time of calculation).<sup>1</sup>
- For the avoidance of doubt, the post-tax cost of equity for use in the above formula is the fixed value shown in the [ED1 Price Control Financial Model](#) for the licensee and is not subject to change during the price control period (even if the corporation tax rate changes).
- See chapter 5 of the ED1 Price Control Financial Handbook for an explanation of CDE.<sup>2</sup>

3.3 The result of the impact analysis is included as Attachment 3.

3.4 The Working Group examined the effects of this CP on the EDCM and concluded that there will be no impact on EDCM all the way tariffs, and a small impact on EDCM LDNO tariffs. The only EDCM input which will be altered by the change to the CDCM rate of return will be the 'CDCM End User Tariffs' for both LRIC and FCP methodologies, which will change in line with the impact analysis provided. These inputs have no impact on the EDCM all the way tariffs, but are combined with the discount percentages calculated in the Extended Price Control Disaggregation Model (Extended PCDM) to calculate LDNO tariffs for LDNO customers where the host DNO/LDNO connection level is above HV, hence there will be a small impact on these tariffs.

#### 4 ASSESSMENT AGAINST THE DCUSA OBJECTIVES

4.1 The Working Group reviewed the CP against the DCUSA Objectives and agree that DCP 230 better facilitates DCUSA General Objective 3 'The efficient discharge by the DNO Parties and IDNO Parties of obligations imposed upon them in their Distribution Licences', and DCUSA Charging Objective 1 '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'.

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<sup>1</sup> <https://www.ofgem.gov.uk/ofgem-publications/92966/schedule2ced1pricecontrolfinancialmodel.zip>

<sup>2</sup> <https://www.ofgem.gov.uk/ofgem-publications/92965/ed1handbookslowtrackfeb2015.pdf>

- 4.2 The Working Group feel that both DCUSA Charging Objective 1 and General Objective 3 are better facilitated as a result of this CP by ensuring that the Rate of Return in the CDCM and EDCM is consistent with the RIIO-ED1 pre-tax cost of capital.

## **5 LEGAL DRAFTING**

- 5.1 The proposed legal drafting is included as Attachment 2.

## **6 IMPLEMENTATION**

- 6.1 The proposed implementation date for DCP 230, subject to Authority consent, is 1 April 2016.

## **7 CONSULTATION**

- 7.1 The Working Group is seeking views on the below questions:

1. Do you understand the intent of DCP 230?
2. Are you supportive of the principles of DCP 230?
3. Do you have any comments on the proposed legal text?
4. The Working Group feel that DCUSA General Objective 3 would be better facilitated by the implementation of DCP 230; please provide your comments on this and any other DCUSA General Objective you feel will be impacted by DCP 230.
5. The Working Group feel that DCUSA Charging Objective 1 would be better facilitated by the implementation of DCP 230; please provide your comments on this and any other DCUSA Charging Objective you feel will be impacted by DCP 230.
6. Do you agree with the approach taken by the Working Group in the Impact Assessment, including the formula used to calculate the results?
7. Do you agree that the approach taken by the Working Group will align with the RIIO-ED1 License?
8. Do you agree with the Working Group's conclusion that this CP will have a minimal effect on the EDCM?

9. Are you aware of any wider industry developments that may impact upon or be impacted by this CP?
  10. Are there any alternative solutions or unintended consequences that should be considered by the Working Group?
- 7.2 Responses should be submitted using Attachment 1 to [DCUSA@electralink.co.uk](mailto:DCUSA@electralink.co.uk) no later than **22 May 2015**.
- 7.3 Responses, or any part thereof, can be provided in confidence. Parties are asked to clearly indicate any parts of a response that are to be treated confidentially.

## **8 NEXT STEPS**

- 8.1 Responses to the Consultation will be reviewed by the DCP 230 Working Group. The Working Group will then determine the progression route for the CP.
- 8.2 If you have any questions about this paper or the DCUSA Change Process please contact the DCUSA Help Desk by email to [DCUSA@electralink.co.uk](mailto:DCUSA@electralink.co.uk) or telephone 020 7432 3014.

## **9 ATTACHMENTS**

Attachment 1 – DCP 230 Consultation Response Form

Attachment 2 – DCP 230 Proposed Legal Drafting

Attachment 3 – DCP 230 Impact Analysis

Attachment 4 – DCP 230 Change Proposal