



DCUSA Consultation	At what stage is this document in the process?
<h1 data-bbox="124 376 1118 472">DCP 332 &amp; DCP 333</h1> <p data-bbox="124 504 1150 719"><b>DCP 332:</b> Appropriate treatment and allocation of Last Resort Supply Payment claim costs</p> <p data-bbox="124 741 1034 956"><b>DCP 333:</b> Appropriate treatment and allocation of eligible use of system bad debt costs</p> <p data-bbox="124 1032 868 1070"><i>Raised as Standard Changes on 12 November 2018</i></p>	01 – Change Proposal
	02 – Consultation
	03 – Change Report
	04 – Change Declaration
<p><b>Purpose of Change Proposal:</b></p> <p><u>DCP 332:</u> The intent of this change proposal is to ensure that associated costs are recovered fairly and equitably from customers where a DNO Party receives a claim from a Supplier of Last Resort for a Last Resort Supply Payment claim.</p> <p><u>DCP 333:</u> The intent of this change proposal is to ensure that associated costs are recovered fairly and equitably from customers where a DNO or IDNO Party incurs eligible use of system bad debt due to the insolvency of electricity suppliers whose supply licence has subsequently been revoked.</p> <p>This document is a Consultation issued to DCUSA Parties and any other interested Parties in accordance with Clause 11.14 of the DCUSA seeking industry views on DCP 332 and DCP 333.</p>	
	<p>The Workgroup recommends that this Change Proposal should proceed to a Consultation.</p> <p>Parties are invited to consider the questions set in section 10 and submit comments using the form attached as Attachment 1 to <a href="mailto:dcusa@electralink.co.uk">dcusa@electralink.co.uk</a> by <b>21 May 2019</b></p> <p>The Working Group will consider the consultation responses and determine the appropriate next steps for the progression of the Change Proposal (CP).</p>
	<p>Impacted Parties: Distribution Network Operators (DNOs), Independent Distribution Network Operators (IDNOs) and Suppliers</p>



Impacted Clauses: Schedule 16, multiple paragraphs.  
Schedule 17 and 18, paragraphs 13, 16, 24 and 25

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Timetable		Any questions? Contact: <b>Huw Neyroud</b> Email Address: <a href="mailto:DCUSA@electralink.co.uk">DCUSA@electralink.co.uk</a> Telephone: <b>020 7432 3011</b> Proposer: <b>Andrew Enzor</b> Email Address: <a href="mailto:andrew.ensor@northernpowergrid.com">andrew.ensor@northernpowergrid.com</a> Telephone: <b>07834 618994</b>
The timetable for the progression of the CP is as follows:		
<b>Change Proposal timetable</b>		
Activity	Date	
Initial Assessment Report Approved by Panel	14 November 2018	
First Consultation issued to Parties	29 April 2019	
Change Report issued to Panel	17 April 2019	
Change Report issued for Voting	19 April 2019	
Party Voting Ends	10 May 2019	
Change Declaration issued to Authority	14 May 2019	
Authority Decision	18 June 2019	
Proposed Implementation Date	01 April 2020	

# 1 Summary

## What?

- 1.1 From time-to-time, an electricity supplier operating in the competitive retail market may have its supply licence revoked by the Authority.
- 1.2 When a supply licence is revoked, Ofgem may appoint a Supplier of Last Resort (SoLR), with all customers of the insolvent supplier then being supplied by the SoLR. Any credit balances held by 'non-business' customers of the insolvent supplier at the time of its supply licence being revoked are protected by Ofgem's Safety Net<sup>1</sup> - in effect, the SoLR becomes liable for any credit balances for non-business customers held by the insolvent supplier at the time of its supply licence being revoked. The safety net guidelines currently state that: "*Business customers' credit balances are not protected under the Safety Net. Business customers should contact the company's administrator to ask them what to do about their credit balances.*" The SoLR may make a claim for a Last Resort Supply Payment (LRSP) to recover such costs, which is split between Gas Distribution Networks (GDNs) and Distribution Network Operators (DNOs), with the GDNs and DNOs in turn recovering the costs from customers via use of system charges. **DCP 332 is primarily concerned with the recovery of the DNOs' share of LRSP claims from customers.**
- 1.3 Prior to having its supply licence revoked, the electricity supplier is likely to have failed to pay outstanding invoices (or invoices yet to be) levied by the distributor, leaving the distributor with bad debt. **DCP 333 is concerned with the recovery of distributor use of system bad debts from customers.**
- 1.4 In January 2019 Ofgem issued a statutory consultation<sup>2</sup> on changes to the distribution licence, affecting both LRSP claims and distributor bad debts. Under the proposals, each DNO will be required to add the costs associated with the appointment of a SoLR and any bad debts to its revenue allowances using new pass-through terms.
- 1.5 DCP 332 and 333 are being progressed in parallel to the review of the licence to ensure an efficient and coordinated implementation. The proposed changes will not be implemented if the associated changes to the electricity distribution licence (which are subject to Ofgem's final decision and 56 day cooling off period that follows) are not approved. This follows precedent set in other codes such as the Uniform Network Code (UNC). As such, with this being a Part 1 matter, it is anticipated that

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<sup>1</sup> <https://www.ofgem.gov.uk/consumers/household-gas-and-electricity-guide/extra-help-energy-services/ofgem-safety-net-if-your-energy-supplier-goes-out-business>

<sup>2</sup> <https://www.ofgem.gov.uk/publications-and-updates/statutory-consultation-modification-electricity-distribution-licence-recover-costs-associated-appointing-supplier-last-resort>

the Authority would only approve these change proposals subject to its approval of consistent changes to the electricity distribution licence.

## Why?

- 1.6 The costs of both LRSP claims and distributor bad debts do not relate to customers' future use of the distribution system. LRSP costs are incurred by DNOs in order to facilitate an equitable apportionment to customers of the costs associated with the protection which customers receive should their supplier have its licence revoked. Bad debt costs are incurred by distributors as a result of an electricity suppliers' failure to pay use of system invoices prior to having its supply licence revoked, or which are due to be invoiced and become eligible for payment after a licence has been revoked, but which relate to the period before that licence was revoked.
- 1.7 Without changes to Schedule 16, the proposed changes to the electricity distribution licence would currently result in all customers contributing to the recovery of LRSP claims and bad debt costs, with unit charges increasing via revenue matching (i.e. 'scaling' or the 'residual'). This is unlikely to present an appropriate means of apportioning such costs to customers.

## How?

- 1.8 The proposed solution is to exclude revenue relating to the appointment of a SoLR and revenue relating to bad debt costs when carrying out the 'revenue matching' step in the Common Distribution Charging Methodology (CDCM) and when calculating charges in the Extra High Voltage (EHV) Distribution Charging Methodology (EDCM). LDNO discounts would be applied to CDCM tariffs calculated at this stage, with a subsequent adjustment made to all tariffs (including those for LDNOs) to recover SoLR and bad debt costs.

# 2 Governance

## Justification for Part 1 Matter

- 2.1 DCP 332 and DCP 333 are both classified as Part 1 Matters and therefore it will be necessary for the changes to be progressed to the Authority for determination after the voting process has completed. This is due to there being an impact on competition in the distribution of electricity, by removing the potential for a distortion caused by the recovery of the costs and bad debt incurred by distributors associated with the appointment of a SoLR.

## Requested Next Steps

- 2.2 Following a review of the Consultation responses, the Working Group will work to agree the detail of the solution for DCP 332 and DCP 333.

## 3 Why Change?

### Background of DCP 332 & DCP 333

#### Supplier of Last Resort costs (DCP 332)

- 3.1 Standard conditions eight and nine of the electricity supply licence make provision for Ofgem to issue a Last Resort Supply Direction, and for a supplier with a Last Resort Supply Direction to make an LRSP claim to GDNs and DNOs. Following recent modifications<sup>3</sup> to the electricity supply licence, a SoLR is required to make the electricity proportion of its approved LRSP claim from each DNO.
- 3.2 Over the past three years, there have been 11 instances of supply licences being revoked (nine being in the last year) and the subsequent appointment of a SoLR:
- GB Energy Supply Ltd ceased trading in November 2016;
  - Future Energy Supply Limited ceased trading in January 2018;
  - Iresa Limited ceased trading in July 2018;
  - Gen4U ceased trading in September 2018;
  - Usio Energy Supply Limited ceased trading in October 2018;
  - Extra Energy Limited ceased trading November 2018;
  - Spark Energy Supply Limited ceased trading in November 2018;
  - One Select Limited ceased trading in December 2018;
  - Economy Energy Limited ceased trading in January 2019;
  - Our Power ceased trading in January 2019; and
  - Brilliant Energy Supply Ltd. ceased trading in March 2019.
- 3.3 Alongside these, recent headlines have suggested that multiple small suppliers are in financial difficulty.
- 3.4 Of the instances noted above, LRSP claims have only been made by:
- Co-operative Energy Limited, in January 2018, in respect of its activities as SoLR for the former customers of GB Energy Supply Ltd.; and
  - Octopus Energy Limited, in January 2019, in respect of its activities as SoLR for the former customers of Iresa Limited.

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<sup>3</sup> <https://www.ofgem.gov.uk/publications-and-updates/decision-modify-solr-supply-licence-conditions>

- 3.5 With the exception of Green Star Energy (a subsidiary of Hudson Energy Supply UK Limited), in respect of its activities as SoLR for the former customers of Future Energy Supply Limited, LRSP claims could yet be made in respect of the remainder of supplier failures listed in paragraph 3.2.
- 3.6 In order to comply with standard condition 38 '*Treatment of payment claims for last-resort supply*' ('SLC38') of the electricity distribution licence in respect of the Co-operative Energy LRSP claim, each DNO was required to increase its use of system charges in 2018/19. 2018/19 charges had been published in December 2016, in line with the DCUSA requirement to give 15 months' notice of a change to use of system charges. Hence, in order to comply with the distribution licence, DNOs requested and were granted derogation from the requirement to provide 15 months' notice when changing 2018/19 charges to recover the LRSP claim costs. A consistent process was followed in respect of the Octopus Energy Limited LRSP claim which impacted 2019/20 charges.
- 3.7 The need for derogation highlights flaws with the existing distribution licence, which are in the process of being addressed. Under changes proposed, each DNO will be required to add SoLR costs to its revenue allowances as a pass-through item.
- 3.8 For the majority of pass-through items in revenue allowances, DNOs recover revenue two years after incurring costs. This will be the case for the SoLR costs, with the exception of costs which breach a defined materiality threshold. Where the materiality threshold is breached, DNOs can give notice to Ofgem of their intent to recover the costs in the next regulatory year if a claim which breaches the materiality threshold is received more than three months from the start of that regulatory year, or the following regulatory year if less than three months.
- 3.9 If the materiality threshold is breached, the licence allows DNOs to change charges without giving 15 months' notice. Under current arrangements DNOs would be required to request derogation from the DCUSA requirement to provide 15 months' notice of a change to charges in this circumstance. A separate DCUSA change<sup>4</sup> is progressing which seeks to conditionally remove the requirement to give 15 months' notice of a change to charges in these circumstances.
- 3.10 If the materiality threshold is breached and charges changed at short notice, the mechanism introduced by DCP 332 for the recovery of SoLR costs should also apply. Hence a simple mechanism of cost recovery will minimise the level of change to charges previously published as final.

### **Eligible Bad Debt (DCP 333)**

- 3.11 DNOs currently recover eligible bad debt by 'logging up' the debt in the current price control period which is subsequently reflected in base allowed revenue in the following price control period; in line with the 2005 best practice guidelines and necessary credit cover arrangements (Schedule 1

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<sup>4</sup> [DCP 340 'Notice period required to recover approved last resort supply payment claims which breach the materiality threshold'](#)

‘Cover’ of the DCUSA). Based on the current arrangements, to recover eligible bad debt incurred in RIIO-ED1, Ofgem will adjust the RIIO-ED2 price control settlement accordingly as part of the RIIO-ED1 close-out process.

- 3.12 In respect of the instances of supply licences being revoked listed in paragraph 3.2, the associated bad debt is material and current arrangements require DNOs to carry the debt throughout RIIO-ED1. Due to the profiling of allowances in the next price control settlement, DNOs will recover the costs throughout the entirety of the next price control, so will not fully recover until the end of RIIO-ED2.
- 3.13 The significant delay in DNOs recovering eligible bad debt has been under review for some time, and in the intervening period DNOs have been required to commence the short-term recovery of third-party costs also incurred by energy suppliers as a result of the revocation of a supply licence; namely the recovery of Co-operative Energy Limited and Octopus Energy Limited’s LRSP claims. IDNOs currently have no mechanism to recover bad debts.
- 3.14 Under changes proposed to the electricity distribution licence, each DNO will be required to add eligible bad debt costs to its revenue allowances as a pass-through item. The licence changes include a process for IDNOs to make a claim for their bad debts from each DNO, with DNOs including IDNO bad debts claims in their eligible bad debt pass-through cost.

### **Treatment of costs**

- 3.15 The costs which will be included in the new pass-through terms do not relate to customers’ future use of the distribution system. The costs are incurred by DNOs in order to facilitate an equitable apportionment to customers of the costs associated with the protection which customers receive should their supplier have its licence revoked, and an equitable apportionment of distributor bad debt costs. Without changes to Schedule 16, the proposed changes to the electricity distribution licence would result in all customers contributing to the recovery of these costs, with unit charges increasing via revenue matching. This is unlikely to present an appropriate means of apportioning such costs to customers.
- 3.16 Consideration is needed as to which customer groups should contribute to the recovery of SoLR and bad debt pass-through costs, and through which tariff element. This should be considered in the context of the ongoing Ofgem-led Targeted Charging Review (TCR), launched via a Significant Code Review (SCR). The current methodologies would result in the recovery of these costs manifesting as a stronger price signal for reduced overall consumption via an increased unit charge. This creates risks that users who are able to reduce overall consumption contribute less to cost recovery, results in additional costs being borne by other users. This is in contradiction to the principles of the TCR, and until the outcome of the TCR is known, the treatment and allocation of these costs should be considered on individual merits. It is worth noting that Ofgem’s minded to



decision<sup>5</sup> on the TCR is to recover the residual via fixed charges, which aligns to the proposed solutions for both DCP 332 and DCP 333.

- 3.17 Careful consideration is also needed for the calculation of tariffs for LDNOs. If the costs associated with the appointment of a SoLR are simply recovered through revenue matching (as would be the case if these changes were not made), an LDNO would benefit from higher potential revenue under its relative price control (as the host DNO charges would increase) but its costs would not increase proportionally as the increase in the host DNO's tariff for customers connected to its network would be discounted when calculating tariffs applicable to the LDNO; hence the LDNO would be a net beneficiary of the process whereby a DNO is primarily, if not entirely, seeking to recover costs for the SoLR only.
- 3.18 This issue has been avoided in the two instances of LRSP claims made to date by only applying an increase in use of system charges to customers connected to DNO networks. However, this effectively exempts customers connected to LDNO networks from contributing to the costs, despite LDNO connected customers receiving the benefits of the safety net in the same way as DNO connected customers.
- 3.19 DCP 332 and 333 are seeking to ensure that an appropriate mechanism is in place which ensures that customers contribute to the recovery of the costs without distorting the underlying cost signals generated by the existing charging methodologies, and without distorting LDNO margins.

**Q1: Do you understand the intent of DCP 332 & DCP 333?**

**Q2: Do you agree with the principles of DCP 332 & DCP 333? If not, please provide your rationale.**

## 4 Code Specific Matters

### Reference Documents

- <https://www.ofgem.gov.uk/consumers/household-gas-and-electricity-guide/extra-help-energy-services/ofgem-safety-net-if-your-energy-supplier-goes-out-business>
- <https://epr.ofgem.gov.uk/Content/Documents/Electricity%20Supply%20Standard%20Licence%20Conditions%20Consolidated%20-%20Current%20Version.pdf>
- <https://www.ofgem.gov.uk/publications-and-updates/statutory-consultation-proposed-modifications-solr-supply-licence-conditions>
- [https://www.ofgem.gov.uk/system/files/docs/2016/11/electricity\\_supply\\_revocation\\_2.pdf](https://www.ofgem.gov.uk/system/files/docs/2016/11/electricity_supply_revocation_2.pdf)

<sup>5</sup> <https://www.ofgem.gov.uk/publications-and-updates/targeted-charging-review-minded-decision-and-draft-impact-assessment>



- [https://www.ofgem.gov.uk/system/files/docs/2016/11/last\\_resort\\_direction\\_template\\_electricity.pdf](https://www.ofgem.gov.uk/system/files/docs/2016/11/last_resort_direction_template_electricity.pdf)
- [https://www.ofgem.gov.uk/system/files/docs/2018/01/fe\\_elec\\_revocation\\_002.pdf](https://www.ofgem.gov.uk/system/files/docs/2018/01/fe_elec_revocation_002.pdf)
- [https://www.ofgem.gov.uk/system/files/docs/2018/01/electricity\\_solr\\_direction.pdf](https://www.ofgem.gov.uk/system/files/docs/2018/01/electricity_solr_direction.pdf)
- [https://www.ofgem.gov.uk/system/files/docs/2018/08/notice\\_of\\_revocation\\_of\\_electricity\\_licence\\_-\\_iresa.pdf](https://www.ofgem.gov.uk/system/files/docs/2018/08/notice_of_revocation_of_electricity_licence_-_iresa.pdf)
- [https://www.ofgem.gov.uk/system/files/docs/2018/07/last\\_resort\\_supply\\_direction\\_-\\_electricity.pdf](https://www.ofgem.gov.uk/system/files/docs/2018/07/last_resort_supply_direction_-_electricity.pdf)
- <https://www.ofgem.gov.uk/publications-and-updates/gen4u-ltd-notice-revocation-electricity-supply-licence>
- <https://www.ofgem.gov.uk/publications-and-updates/ofgem-appoint-octopus-energy-supplier-last-resort-customers-gen4u>
- <https://www.ofgem.gov.uk/publications-and-updates/usio-energy-supply-limited-notice-revocation-gas-supply-licence>
- <https://www.ofgem.gov.uk/publications-and-updates/ofgem-appoints-first-utility-take-customers-usio-energy>
- <http://www.northernpowergrid.com/asset/0/document/4097.pdf>
- [https://www.ofgem.gov.uk/system/files/docs/2018/02/coop\\_solr\\_derogation\\_letter\\_0.pdf](https://www.ofgem.gov.uk/system/files/docs/2018/02/coop_solr_derogation_letter_0.pdf)
- <https://www.ofgem.gov.uk/electricity/transmission-networks/charging/targeted-charging-review-significant-code-review>

## 5 Working Group Assessment

### DCP 332 & DCP 333 Working Group Assessment

- 5.1 The DCUSA Panel established a Joint Working Group to assess DCP 332 and DCP 333 and progress the changes through the DCUSA Change Process.
- 5.2 This Working Group consists of DNO, IDNO and Supplier representatives and an Ofgem Observer. The Working Group meetings are held in open session and the minutes and papers of each meeting are available on the DCUSA website.
- 5.3 The Working Group reviewed the CPs and agreed that a consultation was needed to obtain industry views on the proposed solutions.

### Potential solutions

- 5.4 There are at least four possible solutions to these issues, all of which are variations on the same theme, being that the new pass-through costs are excluded from both the calculation of revenue matching in the CDCM and the calculation of EDCM tariffs. A subsequent adjustment is then made to (a subset of) tariffs, with the same absolute adjustment being made to the tariff for end customers connected to a DNO network and end customers connected to LDNO networks, thus ensuring that LDNOs are entirely neutral to the recovery of costs whilst ensuring that customers connected to LDNO networks contribute to the same level as customers connected to DNO networks. Whilst the potential solutions for DCP 332 and DCP 333 are common, the Working Group is considering each on its own merits, and the ultimate solution may involve using different options for DCP 332 and DCP 333 respectively.
- 5.5 Customers who:

- are connected to LDNO networks where the DNO to LDNO is at the HV Substation network level or above; and
- meet the definition of 'Designated Properties' as defined in the distribution licence, i.e. those who would be treated as CDCM customers if they were connected to a DNO network

have tariffs calculated in the EDCM, by applying discounts to CDCM tariffs. In order to ensure consistent treatment of such customers, these tariffs must also be increased by the same adjustment as is being made to DNO end customer tariffs; hence it will be necessary to create a link between the CDCM and EDCM to ensure that:

- 1) tariffs for Designated Properties connected to LDNO networks which are calculated in the EDCM are subject to the same adjustment as tariffs for customers connected to DNO networks calculated in the CDCM; and
- 2) the adjustment to tariffs (calculated in the CDCM) takes into account revenue which will be derived in the EDCM from the application of step 1, to avoid over-recovery of the new pass-through costs.

5.6 The four options are described in detail below. In summary, they are:

- Option A – costs recovered through unit rates for all demand customers;
- Option B – costs recovered through unit rates for domestic customers;
- Option C – costs recovered through fixed charges for all demand customers with a fixed charge; or
- Option D – costs recovered through fixed charges for domestic customers.

### Option A

5.7 Exclude any revenue relating to the new pass-through costs from the existing calculations for tariffs for users connected to DNO networks and tariffs for LDNOs in both the CDCM and EDCM, with the costs recovered through a subsequent adjustment to all unit rates of all tariffs for all demand customers which are Designated Properties (including those calculated in the EDCM), with the

same p/kWh adjustment being made to all tariffs (including those for LDNOs).

Option A	Pros	Cons
<b>Common to DCP 332 (SoLR) and DCP 333 (Bad Debt)</b>	Maintains the principle by which revenue matching is achieved in the CDCM.	Results in higher unit rates, giving a stronger cost signal to customers to reduce overall usage of the network. The costs associated with the new pass-through terms cannot be reduced through reduced network usage, and so this stronger cost signal is not appropriate and contradicts the principles set out in Ofgem's TCR.
<b>DCP 332 (SoLR)</b>		Results in all customers contributing to the costs associated with the appointment of a SoLR, where only 'non-business' customers benefit from the safety net which protects credit balances; hence arguably creates a cross-subsidy from industrial and commercial to domestic customers.  If the materiality threshold is breached, charges for all customers could change at short notice.
<b>DCP 333 (Bad Debt)</b>	The costs do not discriminate against different types of customers; hence recovery from all customers is arguably more appropriate than from a subset.	

## Option B

- 5.8 Exclude any revenue relating to the new pass-through costs from the existing calculations for tariffs for users connected to DNO networks and tariffs for LDNOs in both the CDCM and EDCM, with the costs recovered through a subsequent adjustment to the unit rates of tariffs for domestic customers (including those calculated in the EDCM), with the same p/kWh adjustment being made to all tariffs

for domestic customers (including those for LDNOs).

Option B	Pros	Cons
<b>Common to DCP 332 (SoLR) and DCP 333 (Bad Debt)</b>	Maintains the principle by which revenue matching is achieved in the CDCM, albeit applied to a restricted group of customers.	Results in higher unit rates, giving a stronger cost signal to customers to reduce overall usage of the network. The costs associated with the new pass-through terms cannot be reduced through reduced network usage, and so this stronger cost signal is not appropriate and contradicts the principles set out in Ofgem's TCR.
<b>DCP 332 (SoLR)</b>	Domestic customers are considered to represent the primary beneficiaries of the protection which the safety net provides. This option ensures that only domestic customers contribute to the costs associated with the appointment of a SoLR.  If the materiality threshold is breached, only a small number of tariffs would change at short notice.	
<b>DCP 333 (Bad Debt)</b>		Unpaid use of system invoices may include charges in respect of all types of customer. However, a distributor incurring new eligible bad debt is likely to be associated with the same trigger as the appointment of a SoLR, therefore the bad debt will relate to the same customer base and which to date is almost entirely associated with domestic customers.

## Option C

- 5.9 Exclude any revenue relating to the new pass-through costs from the existing calculations for tariffs for users connected to DNO networks and tariffs for LDNOs in both the CDCM and EDCM, with the costs recovered through a subsequent adjustment to the fixed charges of tariffs for all demand customers which are Designated Properties (including those calculated in the EDCM), with the same p/day adjustment being made to all tariffs for all customers who receive a fixed charge (i.e. all except unmetered supplies and 'related MPAN' tariffs).

Option C	Pros	Cons
<b>Common to DCP 332 (SoLR) and DCP 333 (Bad Debt)</b>	The costs associated cannot be reduced through reduced network usage; hence a fixed charge is arguably the most appropriate means of recovery.	Deviates from the underlying principle by which revenue matching is achieved in the CDCM.
<b>DCP 332 (SoLR)</b>		Results in all customers contributing to the costs associated with the appointment of a SoLR, where only 'non-business' customers benefit from the safety net which protects credit balances; hence arguably creates a cross-subsidy from industrial and commercial to domestic customers.  If the materiality threshold is breached, charges for all customers could change at short notice.
<b>DCP 333 (Bad Debt)</b>	The costs do not discriminate against different types of customers; hence recovery from all customers is arguably more appropriate than from a subset.	

## Option D

- 5.10 Exclude any revenue relating to the new pass-through costs from the existing calculations for tariffs for users connected to DNO networks and tariffs for LDNOs in both the CDCM and EDCM, with the new pass-through costs recovered through a subsequent adjustment to the fixed charges of tariffs for domestic customers (including those calculated in the EDCM), with the same p/day adjustment

being made to all tariffs for domestic customers (including those for LDNOs).

Option D	Pros	Cons
<b>Common to DCP 332 (SoLR) and DCP 333 (Bad Debt)</b>	The costs associated with the new pass-through terms cannot be reduced through reduced network usage; hence a fixed charge is arguably the most appropriate means of recovery.	Deviates from the underlying principle by which revenue matching is achieved in the CDCM.
<b>DCP 332 (SoLR)</b>	Domestic customers are considered to represent the primary beneficiaries of the protection which the safety net provides. This option ensures that only domestic customers contribute to the costs associated with the appointment of a SoLR.  If the materiality threshold is breached, only a small number of tariffs would change at short notice.	
<b>DCP 333 (Bad Debt)</b>		Unpaid use of system invoices may include charges in respect of all types of customer. However, a distributor incurring new eligible bad debt is likely to be associated with the same trigger as the appointment of a SoLR, therefore the bad debt will relate to the same customer base and which to date is almost entirely associated with domestic customers.

## Options to Progress

- 5.11 The Working Group discussed the options presented in the change proposal. There was unanimous agreement that recovery of these pass-through costs through unit charges was not appropriate. Hence the Working Group is not proposing to consider Options A and B further.
- 5.12 The Working Group also unanimously agreed that Option D was the only appropriate option for the recovery of SoLR costs, because those costs primarily relate to the credit balances of domestic customers. Hence the Working Group is not proposing to consider Option C further for DCP 332.
- 5.13 The Working Group discussed the merits of Options C and D for the recovery of bad debt costs and did not reach a unanimous conclusion, with both options having advantages and disadvantages (as detailed in the tables above). Hence the Working Group intends to consider both Options C and D for DCP 333, and will make a decision on which to progress following consultation responses.

**Q3: Do you agree with the Working Group that Option D is appropriate for DCP 332? If not, which option do you consider to be more appropriate? Please provide your rationale.**

**Q4: Do you agree with the Working Group that Option C or Option D is appropriate for DCP 333? If so, which option would be your preference? If not, which option do you consider to be more appropriate? Please provide your rationale.**

## Modelling Impact Assessment

- 5.14 As a result of the above options being developed, the Working Group instructed the DCUSA modelling provider to develop two versions of the CDCM and EDCM models in support of these changes:
- One scenario implements Option D for DCP 332 and Option D for DCP 333.
  - One scenario implements Options D for DCP 332 and Option C for DCP 333.
- 5.15 The DCUSA modelling provider calculated the impact on CDCM tariffs, as well as on total revenue recovered per MPAN and per kWh from different tariff categories. This impact assessment was based on using the value of LRSP claims made to each DNO by Octopus Energy Limited in January 2019, and illustrative bad debt of £250k for each DNO.
- 5.16 The “base” impact assessments (without the new revenues included) returned no difference in costs for all-the-way tariffs compared to the original model without the CPs implemented. The impacts are in line with expectations, in that they increase the fixed charges of the customer to whom the methodology is allocating revenue associated with SoLR and bad debt costs. As expected, when the bad debt costs are not included, then the two variants of the model provide identical results (since they both use Option D for DCP 332).
- 5.17 The extent of the fixed charge increase is higher when there is more cost to be allocated, i.e. when there are revenues associated with bad debt as well as SoLR costs. The difference between Option C and Option D for DCP 333 is relatively minor, as the additional customer categories that Option C includes the calculation do not represent a very large number of customers, meaning the change in fixed charge adder is not that large.
- 5.18 Absolute impacts on LDNO tariffs are almost identical to those on all-the-way tariffs, with the exception of some  $\pm 0.001$  changes in unit rates and some  $\pm 0.01$  changes in other charges due to rounding
- 5.19 These small changes also occurred in the “base” scenario when compared to published charges. This is because of rounding, as the structure of the rounding calculations has been changed. Previously, the LDNO discounted tariffs were calculated by applying the discount percentages to the rounded all-the-way tariffs, but they are now calculated based on applying the discount



percentages to the unrounded all-the-way tariff. This means that, previously, LDNO tariffs were essentially being rounded twice – in the updated model, they are only being rounded once.

- 5.20 For some of the larger LDNO tariff categories, this difference leads to changes in bills in the order of £10s per customer per year. This is due to the rounding differences for capacity and unit rate charges which are then applied to large volumes of kWh or large values of capacity. The percentage differences are still very small (typically less than 1%).
- 5.21 In addition, the increases in the fixed adders are higher (in percentage terms) for LDNO LV customers than all-the-way customers and even higher for LDNO HV customers. This is because the new fixed charge adders are not discounted, and LDNO connected customers are still to pay 100% of their share of the SoLR and Bad Debt costs.
- 5.22 DNO Working Group members are comfortable with the outcomes of the modelling impact assessment work that has been completed by the DCUSA modelling provider. The full impact assessment report and all of the updated models can be found in Attachment 3.

## 6 Relevant Objectives

### Assessment Against the DCUSA Objectives

- 6.1 The Proposer considers that the following DCUSA Objectives are better facilitated by DCP 332 and DCP 333.

#### Impact of the Change Proposal on the Relevant Objectives:

Relevant Objective	Identified impact
<input type="checkbox"/> 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	Neutral
<input checked="" type="checkbox"/> 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)	Positive
<input checked="" type="checkbox"/> 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	Positive
<input checked="" type="checkbox"/> 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	Positive
<input type="checkbox"/> 5 – that compliance by each DNO Party with the Charging Methodologies facilitates compliance with the Regulation on Cross-Border Exchange in Electricity and any relevant	Neutral

legally binding decisions of the European Commission and/or the Agency for the Co-operation of Energy Regulators.	
<input type="checkbox"/> 6 – that compliance with the Charging Methodologies promotes efficiency in its own implementation and administration.	Neutral

6.2 The Proposer's views and explanations for the assessment against the Objectives are displayed below:

Charging Objective	DCP 332 (SoLR)	DCP 333 (Bad Debt)
1	No impact	
2	Better facilitated by avoiding the distortions which would occur in tariffs for LDNOs if the change were not made.	
3	Better facilitated by all options by ensuring that costs associated with the appointment of a SoLR are allocated to customers appropriately. Options which ensure these costs are only recovered from domestic users are likely to be the most cost reflective, to avoid a non-cost reflective cross-subsidy from industrial and commercial to domestic customers. The costs to be recovered cannot be reduced by reduced network usage, so this objective will be better facilitated by options which ensure these costs are recovered through fixed charges. Hence Option D is considered to facilitate this objective most fully, followed by option B, followed by option C, followed by option A.	Better facilitated by all options by ensuring that eligible bad debt costs are allocated to customers appropriately. Options which ensure these costs are recovered from all users are likely to be the most cost reflective, to ensure all customers contribute. The costs to be recovered cannot be reduced by reduced network usage, so this objective will be better facilitated by options which ensure these costs are recovered through fixed charges. Hence Option C is considered to facilitate this objective most fully, followed by option A, followed by option D, followed by option B.
4	Better facilitated by ensuring appropriate allocation of pass-through costs in the CDCM.	
5	No impact	
6	No impact	

6.3 The Working Group is now seeking views on whether Parties consider that the proposals better facilitate the DCUSA Charging Objectives or if the impact is differing to that of the view of the Proposer.

**Q5: Which of the DCUSA Objectives does the implementation of DCP 332 and DCP 333 better facilitate? Please provide your rationale.**

## 7 Impacts & Other Considerations

### Does this Change Proposal impact a Significant Code Review (SCR) or other significant industry change projects, if so, how?

- 7.1 The Working Group have highlighted an impact on DNOs, IDNOs and Suppliers. However, did not foresee any system impacts, as the change will use existing tariff structures and will only impact the rates calculated.
- 7.2 The Working Group agreed that depending on the desired solution there is a potential link with the TCR SCR, in that the change is linked to the mechanism by which revenue matching is achieved.
- 7.3 However, the solutions proposed in this change proposal only include revenue relating to SoLR and bad debt costs and so leave the application of revenue matching unaltered for the remainder of DNO revenue i.e. this change deals with costs which are currently not allocated or recovered as part of the distribution charging methodologies or indeed DNO allowed distribution network revenue.
- 7.4 As detailed throughout this consultation document, the changes are in progress for the distribution licence and this is the main driver for these DCUSA changes which has been discussed with Ofgem as part of the review of licensing arrangements.

**Q6: Are you aware of any wider industry developments that may impact upon or be impacted by DCP 332 or DCP 333? Please provide your rationale.**

### Consumer Impacts

- 7.5 The Working Group considered that this change may have an impact on Consumers due to the related costs which will be recovered. The impact varies relative to the chosen solution.

### Environmental Impacts

- 7.6 In accordance with DCUSA Clause 11.14.6, the Working Group assessed whether there would be a material impact on greenhouse gas emissions if DCP 332 and DCP 333 were implemented. The Working Group did not identify any material impact on greenhouse gas emissions from the implementation of these CPs.

### Engagement with the Authority

- 7.7 Ofgem has been fully engaged throughout the development of modifications to the licence, and DCP 332 and DCP 333 as an Observer of the Working Group.

## 8 Legal Text

- 8.1 Three sets of draft legal text for Schedules 16, 17 and 18 have been provided as attachments 4, 5 and 6. These are:

- Attachment 4 – DCP 332 legal text reflecting the Working Groups favoured option.
- Attachment 5 – DCP 333 legal text reflecting Option C as favoured by some of the Working Group.
- Attachment 6 – DCP 333 legal text reflecting Option D as favoured by some of the Working Group.

- 8.2 The proposed text is similar for each of these three. Changes made to Schedule 16 introduce a fifth step in the calculation process for the allocation of SoLR and bad debt costs, with the details on allocation included as paragraphs 100 and 101. Changes to Schedules 17 and 18 are predominantly to the section governing LDNO discounts, with the change to LDNO tariffs as a result of these changes detailed in paragraph 25.3.
- 8.3 The DCP 332 legal text includes different model versions to be used for 2020/21 should the materiality threshold be breached, as detailed in section 9 of this consultation. Once DCP 332 is established, the need for different model versions will fall away. This is necessary for 2020/21 only where charges have previously been published using models which do not include DCP 332 but the changes to the distribution licence could result in a need to change 2020/21 charges. It is anticipated that a future DCUSA change will return these clauses to their previous format of defining a single model version to be used.
- 8.4 Once the Working Group has decided which option will be progressed for DCP 333, consolidated legal text will be compiled including both DCP 332 and 333.

**Q7: Do you have any comments on the proposed legal text for DCP 332 or DCP 333? Please provide your rationale.**

## 9 Implementation

- 9.1 The implementation approach for the two changes differs. This is because the first year in which the changes to the distribution licence can impact charges differs between the changes for SoLR costs (DCP 332) and bad debt costs (DCP 333).

### **Supplier of Last Resort costs (DCP 332)**

- 9.2 As detailed in paragraph 3.8, SoLR costs will typically be included in revenue allowances with a two-year lag. In these circumstances, the requirement to provide 15 months' notice of charges will be maintained. Charges have already been set for 2020/21, so under these circumstances the first year in which this change could take effect would be 2021/22.
- 9.3 But if the materiality threshold is breached, the licence changes allow a DNO to change charges without providing 15 months' notice. Under current arrangements, this would require a direction from Ofgem that the requirement to give 15 months' notice need not apply, as was the case for the

Cooperative Energy Limited claim in January 2018<sup>6</sup> and the Octopus Energy Limited claim in January 2019<sup>7</sup> respectively. As noted, DCP 340 is progressing and seeks to avoid the need for such derogations in the future. Subject to implementation of the licence modifications which Ofgem is consulting on, if the materiality threshold were to be breached before or on 31 December 2019, a DNO could amend previously published charges for 2020/21. Hence the implementation date for DCP 332 is 1 April 2020.

- 9.4 In order to avoid a need for DNOs to publish new CDCM models for 2020/21 if the materiality threshold is not breached, the legal text has been drafted to require DNOs to use different model versions for 2020/21 charges depending on whether 15 months' notice is being provided. So if the materiality threshold is not breached, the CDCM models which DNOs have already published for 2020/21 will remain unaltered. If the materiality threshold is breached, DNOs will be required to publish a new CDCM model which includes DCP 332.

#### **Bad Debt costs (DCP 333)**

- 9.5 Bad debt costs will be included in revenue allowances with a three-year lag. The requirement to provide 15 months' notice of charges will be maintained. Charges have already been set for 2020/21, so the first year in which this change could take effect would be 2021/22. Hence the implementation date for DCP 333 is 1 April 2021.

**Q8: The proposed implementation date for DCP 332 is 01 April 2020 and for DCP 333 is 01 April 2021. Do you agree with the proposed implementation dates?**

## **10 Consultation Questions**

10.1 The Working Group is seeking industry views on the following consultation questions:

Number	Questions
1	Do you understand the intent of DCP 332 & DCP 333?
2	Do you agree with the principles of DCP 332 & DCP 333? If not, please provide your rationale.

<sup>6</sup> [https://www.ofgem.gov.uk/system/files/docs/2018/02/coop\\_solr\\_derogation\\_letter\\_0.pdf](https://www.ofgem.gov.uk/system/files/docs/2018/02/coop_solr_derogation_letter_0.pdf)

<sup>7</sup> <https://www.ofgem.gov.uk/publications-and-updates/last-resort-supplier-payment-claim-octopus-energy-final-decision>

3	Do you agree with the Working Group that Option D is appropriate for DCP 332? If not, which option do you consider to be more appropriate? Please provide your rationale.
4	Do you agree with the Working Group that Option C or Option D is appropriate for DCP 333? If so, which option would be your preference? If not, which option do you consider to be more appropriate? Please provide your rationale.
5	Which of the DCUSA Objectives does the implementation of DCP 332 and DCP 333 better facilitate? Please provide your rationale.
6	Are you aware of any wider industry developments that may impact upon or be impacted by DCP 332 or DCP 333? Please provide your rationale.
7	Do you have any comments on the proposed legal text for DCP 332 or DCP 333? Please provide your rationale.
8	The proposed implementation date for DCP 332 is 01 April 2020 and for DCP 333 is 01 April 2021. Do you agree with the proposed implementation date?

10.2 Responses should be submitted using Attachment 1 to [dcusa@electralink.co.uk](mailto:dcusa@electralink.co.uk) no later than **21 May 2019**.

10.3 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.

## Attachments

- Attachment 1 – DCP 332 and DCP 333 Consultation Response Form
- Attachment 2 – DCP 332 and DCP 333 Change Proposal Forms
- Attachment 3 – DCP 332 and DCP 333 Modelling Impact Assessment Documents
- Attachment 4 – DCP 332 Draft Legal Text
- Attachment 5 – DCP 333 Option C Draft Legal Text
- Attachment 6 – DCP 333 Option D Draft Legal Text