

Proposed modification:	Distribution Connection and Use of System Agreement (DCUSA) DCP251 and 252 – Clarification and Extension of the Application of LDNO Tariffs under the CDCM (251) /EDCM (252)		
Decision:	The Authority ¹ has decided to reject ² these modifications ³		
Target audience:	DCUSA Panel, Parties to the DCUSA and other interested parties		
Date of publication:	22 August 2017	Implementation date:	n/a

Background

The distribution network in Great Britain consists of 14 distribution service areas (DSAs), each operated by a distribution network operator (DNO). There are some smaller networks within these DSAs, which are owned by licensed distribution network operators (LDNOs). An LDNO can be either an independent distribution network operator (IDNO) or a DNO operating outside of its own DSA.

The charges that the LDNOs pay to the respective DNOs to operate within their DSA are discounted to reflect the fact that the LDNO provides the 'last mile' of the distribution network. LDNO tariffs should be applied to licensed distributors in respect of networks where they connect to a 'host' electricity Distribution System. Within the distribution charging methodologies (CDCM⁴ and EDCM⁵), LDNO tariffs are not available to licence-exempt distributors.

The modification proposal

The Electricity Network Company Ltd raised two related modification proposals (one proposing changes to the CDCM – DCP251, and one proposing changes to the EDCM – DCP252) to:

1. Correct drafting errors in the specification of the distribution systems that are eligible for LDNO tariffs under the CDCM and under the EDCM.
2. Ensure that the charging methodologies do not impose undue discrimination between licensed and licence-exempt distributors.

The proposals do not seek to introduce a new IDNO methodology or to change charging arrangements in place for providing Use of System to other distribution networks. Rather, they seek to clarify the types of networks that should qualify for the existing LDNO tariffs. They would do this by introducing a new definition of Qualifying Network Operator (QNO) to include both LDNOs and licence-exempt distributors.

In particular, the proposed changes would extend the application of LDNO tariffs to licence-exempt distributors, subject to strict conditions about metering, openness to competition and duties to provide data. These conditions are designed to ensure equivalence with LDNOs. This would ensure that the host distributor only provides services to the licence-exempt distributor on an equivalent basis to the service provided to an LDNO. Currently, host distributors typically provide a greater level of service to licence-exempt distributors than to LDNOs.

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

³ 'Change' and 'modification' are used interchangeably in this document.

⁴ Common Distribution Charging Methodology.

⁵ Extra High Voltage Distribution Charging Methodology.

The original proposal identified that the change would better meet two of the Applicable Charging Methodology Objectives as defined in condition 22A Electricity Distribution Standard Licence Conditions:

- The first Applicable Charging Methodology Objective⁶, by correcting errors in the methodology statement.
- The second Applicable Charging Methodology Objective⁷, by removing undue discrimination between licensed and licence-exempt distributors.

The proposals were discussed by a working group and were subject to two industry consultations. Respondents expressed mixed views as to whether the current arrangements discriminate against licence-exempt distributors. The Working Group reached a view that the third Applicable Charging Methodology Objective was more relevant for assessment of these modifications than the first. The sixth Applicable Charging Methodology Objective was introduced after the proposals were submitted.

DCUSA Parties' recommendation

The Change Declarations for DCP251 and 252 indicate that all parties were eligible to vote. In the DNO party category, there was a weighted majority support for the proposals but weighted majority rejection for the proposed implementation dates. In the IDNO party category, there was unanimous rejection of the proposals and majority rejection of the proposed implementation dates. In accordance with the weighted vote procedure, the recommendation to the Authority is that both DCP251 and 252 should be rejected. The outcome of the weighted vote is set out in the tables below:

DCP251	WEIGHTED VOTING (%)							
	DNO		IDNO/OTSO ⁸		SUPPLIER		DG ⁹	
	Accept	Reject	Accept	Reject	Accept	Reject	Accept	Reject
CHANGE SOLUTION	54%	46%	0%	100%	n/a	n/a	n/a	n/a
IMPLEMENTATION DATE	40%	60%	33%	67%	n/a	n/a	n/a	n/a

DCP252	WEIGHTED VOTING (%)							
	DNO		IDNO/OTSO		SUPPLIER		DG	
	Accept	Reject	Accept	Reject	Accept	Reject	Accept	Reject
CHANGE SOLUTION	54%	46%	0%	100%	n/a	n/a	n/a	n/a
IMPLEMENTATION DATE	40%	60%	0%	100%	n/a	n/a	n/a	n/a

Our decision

We have considered the issues raised by the proposals and the Change Declarations and Change Reports dated 18 July 2017. In line with our principal objective and statutory duties under section 3A to 3D of the Electricity Act 1989, we have considered and taken into account the vote of the DCUSA Parties on the proposals which are attached to the Change Declaration. We have concluded that the implementation of these modification proposals will not better facilitate the achievement of the Applicable Charging Methodology Objectives.¹⁰

⁶ In accordance with condition 22A.6 Electricity Distribution Standard Licence Condition, the "Applicable Charging Methodology Objective is that compliance with the Relevant Charging Methodology facilitates the discharge by a Distribution Service Provider of the obligations imposed on it under the Act and by this Licence".

⁷ In accordance with condition 22A.7 Electricity Distribution Standard Licence Condition, the "Applicable Charging Methodology Objective is that compliance with the Relevant Charging Methodology 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".

⁸ Offshore Transmission System Operator

⁹ Distributed Generation

¹⁰ The Applicable Charging Methodology Objectives are set out in Standard Licence Condition 22A of the Electricity Distribution Licence. Every modification proposal raised under the DCUSA in relation to a Relevant

Reasons for our decision

As explained in further detail below, we consider that neither of these modification proposals will better facilitate the second and third Applicable Charging Methodology Objectives. Whereas DCP252 could have a positive impact against DCUSA charging objective 6, by correcting some drafting errors, it does not better facilitate the achievement of the objectives overall. These modification proposals are neutral to all other Applicable Charging Methodology Objectives. Consequently, both DCP251 and DCP252 should be rejected.

- a) *Second Applicable Charging Methodology Objective: facilitate competition in the generation and supply of electricity and not restrict, distort, or prevent competition in the transmission or distribution of electricity or in participation in the operation of an Interconnector*

The working group that assessed these modifications could not reach a consensus as to whether the modifications better meet this objective by reducing distortions. The working group concluded that the proposals do not facilitate compliance as the changes create a distortion where a licence-exempt distributor could choose their charging arrangement – which is not available to LDNOs. Voting was also split on this objective, but with the majority stating that this objective is not better facilitated. Additional arguments against included the risk of gaming by owners of larger commercial premises through the creation of separate metering for their subsidiaries. Even those that supported the proposal raised concerns about the additional distortions introduced between licence-exempt distributors and LDNOs.

Our view is that the changes do not better facilitate this objective. While we recognise the aim of the proposals is to reduce potential distortions regarding the service provided by the host distributor to LDNOs and licence-exempt distributors, it also has the potential to introduce distortions by giving licence-exempt distributors a choice of tariffs not available to LDNOs. We have not been presented with compelling evidence that, on balance, this objective would be better facilitated. Furthermore, we are concerned about the risk of introducing gaming opportunities that could distort competition.

- b) *Third Applicable Charging Methodology Objective: 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*

The working group which assessed these modifications had reservations about the extent to which the changes improve cost reflectivity of charges. They noted that part of the tariffs would be derived only based on data from licensed operators (ie excluding data from licence-exempt distributors), that licence-exempt distributors would have a choice between pricing options (implying that they would not be equally cost reflective as one another) and the uncertain costs of implementing the solution.

These concerns were expressed in the votes, with no party producing a compelling argument for how this objective is better facilitated. One party commented on the additional services (and associated costs) involved in being an LDNO and could not foresee a licence-exempt distributor that would be able to provide these additional services in order to access the QNO tariffs.

Charging Methodology and any modification of the methodology that may arise from such a proposal will be assessed by reference to the Applicable Charging Methodology Objectives specified in the condition 22A, and not the Applicable DCUSA Objectives specified in standard condition 22.

We agree with the working group assessment that this objective is not better facilitated and risks reducing cost reflectivity, for the reasons given by the working group. A strong case has not been made to the contrary.

c) *Sixth Applicable Charging Methodology Objective: promote efficiency in the methodology's own implementation and administration*

We agree with the working group assessment that DCP252 could have a positive impact against this objective as it would address a drafting error in the EDCM (schedules 17 and 18 of the DCUSA) and clarify that LDNO tariffs apply to DNOs operating out of area as well as INDOs. However, any such benefit is outweighed by the negative impacts identified against the other DCUSA charging objectives, as set out above. Furthermore, implementation of DCP252 relies on implementation of DCP251. As we have rejected DCP251, we must also reject DCP252.

d) *Additional comments including relating to Ofgem's principal objective*

For both proposals, we are concerned that if licence-exempt distributors were to take up these LDNO tariffs, there would be a shortfall in revenue for the DNO, which would need to be recovered from the wider customer base. Though the shortfalls would be unlikely to be material in the short term, such a transfer of liability over which the wider customer base would have no control would be inconsistent with our principal objective to protect the interests of current and future energy consumers.

Overall, these modifications, which began nearly two years ago, resulted in an equivocal case being presented by the working group, that was not supported by the proposer. These modifications did, though, give rise to discussions about the treatment of customers of licence-exempt distributors. We invite industry parties to continue to consider these issues as part of the ongoing industry-led reviews of the CDCM and EDCM.

We also consider that a further appropriate modification proposal could be raised to seek to correct the drafting errors in Schedules 17 and 18 identified under DCP252.

Decision notice

In accordance with standard licence condition 22.14 of the Electricity Distribution Licence, the Authority has decided that modification proposals DCP251 and 252 – *Clarification and Extension of the Application of LDNO Tariffs under the CDCM / EDCM* should not be made.

Andrew Self

Head of Electricity Network Charging – Energy Systems

Signed on behalf of the Authority and authorised for that purpose