

Proposed variation:	Distribution Connection and Use of System Agreement (DCUSA) DCP136 – Notice period for asset cost changes in the CDCM		
Decision:	The Authority ¹ directs that proposal DCP136 be made ²		
Target audience:	DCUSA Panel, Parties to the DCUSA and other interested parties		
Date of publication:	5 December 2012	Implementation Date:	7 December 2012

Background to the modification proposal

In order to establish tariffs and negotiate contracts with their customers, electricity suppliers have to make an assessment of future levels of network charges. The accuracy of their assessment of future charges can be reflected in the risk margin/premium that they build into their supply contracts. Some of the parameters used to develop future network charges can be changed by the Distribution Network Operators (DNOs) and are outside the control of suppliers.

One set of parameters which contribute to the development of final Distribution Use of System (DUoS) charges are the asset costs in input tables 1020, 1022 and 1023 of the Common Distribution Charging Methodology (CDCM).³ These tables contain the costs from the 500MW model and the LV and HV service models.⁴ DNOs update these tables with the latest cost data available to them which are then used in setting DUoS charges. Currently, these tables can be updated up to three months in advance of their use in setting charges. So, for charges to be applied from April in any year, the latest time by which these inputs can be updated is the previous December. Some suppliers consider that this does not give them sufficient advance notice of changes to these parameters to allow them to factor the changes into their prices. As a result, the potential risk premia associated with changes to network charges may be higher than if these inputs are known further in advance.

Under DCMF Methodologies Issues Group (MIG) "Supergroup"⁵ performed analysis of the impact of changes in the asset costs. They concluded that such changes can cause unpredictable volatility in charges. One proposal to address this issue was to fix the asset costs and up-rate them by inflation each year to give greater predictability. However, the Supergroup considered that this would have too great an impact on cost reflectivity because inflation might not be an accurate measure of changes to these costs.

The modification proposal

DCP136 was raised by British Gas (the proposer) in June 2012. The proposer considers that the predictability of DUoS charges can be improved by requiring 15 months' notice of any changes to the costs in the CDCM input tables mentioned above in advance of their use in setting DUoS charges. Under the proposal, changes could be made only up to the third working day of January, 15 months in advance of a 1 April tariff change in the following year.

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 The CDCM is set out in Schedule 16 of the Distribution Connection and Use of System Agreement (DCUSA). It gives the methods, principles, and assumptions underpinning the calculation of DUoS charges by each DNO.

⁴ The 500MW model determines the annualised cost corresponding to amortisation and return on capital for assets at the LV circuits, HV/LV and HV network levels. This represents a costed design for a 500MW incremental addition to the DNO's network. The service models determine the number and types of connections and a total construction cost for a range of typical assets operated for the benefit of LV and HV network users.

⁵ Information about the MIG "Supergroup" is available from the Energy Networks Association (ENA):

[http://www.energynetworks.org/electricity/regulation/commercial-operations-group/charging-structure/use-of-system/stakeholders/dcmf/distribution-charging-methodologies-forum-\(dcmf\).html](http://www.energynetworks.org/electricity/regulation/commercial-operations-group/charging-structure/use-of-system/stakeholders/dcmf/distribution-charging-methodologies-forum-(dcmf).html)

DCP136 was proposed as a compromise between the current arrangements and the solution that had been considered by the MIG Supergroup. DCP136 intends to strike an appropriate balance between predictability (which can help to facilitate competition) and cost reflectivity. It seeks to provide improved predictability by giving sufficient advance notice of changes to the costs in the input tables, while maintaining cost reflectivity by giving the DNOs the ability to update the costs on an annual basis.

The proposer considers that this change proposal would better facilitate the achievement of DCUSA Charging Objectives 3.2.1 and 3.2.2,⁶ and DCUSA General Objectives 3.1.2 and 3.1.3.⁷ A working group was established to develop and assess the change proposal. It issued a consultation on 31 July 2012 to determine whether parties understood and supported the intent of DCP136. All respondents indicated that they understood and supported the intent of the proposal. The majority of respondents also agreed that the proposal would better facilitate DCUSA Charging Objective 3.2.2 and DCUSA General Objective 3.1.2.

DCUSA Parties' recommendation

The Change Declaration for DCP136 indicates that DNO, Independent Distribution Network Operator (IDNO)/Offshore Transmission System Operator (OTSO), Supplier and Distributed Generation (DG) parties were eligible to vote on DCP136. In the IDNO/OTSO and Supplier party categories, there was unanimous support for the proposal and for its proposed implementation date. In the DNO party category, the vote was split, with a slight majority rejecting the proposal and its proposed implementation date. Seven DNO licensees voted to accept and seven voted to reject the proposal. The voting by DNOs is weighted according to the aggregate number of metering points (MPANs) of each DNO. As all party categories did not vote in favour of the proposal, the recommendation to us is that DCP136 be rejected, in accordance with the weighted vote procedure. The outcome of the weighted vote is set out in the table below:

DCP136	WEIGHTED VOTING (%)							
	DNO		IDNO/OTSO		SUPPLIER		DG	
	Accept	Reject	Accept	Reject	Accept	Reject	Accept	Reject
CHANGE SOLUTION	47	53	100	0	100	0	n/a	n/a
IMPLEMENTATION DATE	47	53	100	0	100	0	n/a	n/a

Our decision

We have considered the issues raised by the proposal and the Change Declaration dated 15 November 2012. 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 DCP136 will better facilitate the achievement of the DCUSA Charging Objectives;⁸ and
- directing that the change is approved is consistent with our principal objective and statutory duties.⁹

⁶ The DCUSA Charging Objectives are set out in Part A of standard licence condition 22A of the Electricity Distribution Licence and are also set out in Clause 3.2 of the DCUSA.

⁷ The DCUSA General Objectives are set out in Part A of standard licence condition 22 of the Electricity Distribution Licence and are also set out in Clause 3.1 of the DCUSA.

⁸ 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.

⁹ Our statutory duties are wider than matters that the Panel must take into consideration and are detailed mainly in the Electricity Act 1989, as amended.

Reasons for our decision

This section provides our reasons for approving the change proposal against those DCUSA Charging Objectives which, in our view, are relevant to our decision. For the remaining DCUSA Charging Objectives, we consider that the proposal has a neutral, or no impact.

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)

We consider that DCP136 should improve competition in the supply of electricity. It would be expected to achieve this by providing greater predictability of DUoS charges for suppliers by requiring a longer notice period for changes to the asset cost inputs. This increased notice period reduces the risk faced by suppliers, and consumers, of cost shocks (both up and down), and therefore should give suppliers a better basis for pricing DUoS charges into the contracts that they offer their customers and should reduce the hedging/risk premia costs built into their prices to account for charging volatility. This in turn could reduce costs imposed on suppliers and thus help reduce potential barriers to entry to the supply market as suppliers would face lower cash flow risks and would need to hold less capital to withstand any such shocks. We expect that this should increase the level of competition in the supply market, particularly by benefitting small suppliers. The proposal should also reduce the barriers to suppliers offering predictable, long term contracts to customers adding further competition within this part of the market.¹⁰

Following a number of discussions over time with smaller suppliers, we are concerned that DUoS charge volatility can have a significant impact on smaller suppliers. This is partly because they have fewer resources to forecast network charges, and partly due to greater pressure on cash flow. Some smaller suppliers also specialise in particular markets and products, and so have less scope and flexibility for absorbing changes in their costs.

As a result we consider that this proposal should be expected to help improve competition in the supply market by giving suppliers greater predictability of changes to the relevant CDCM inputs and hence potentially greater predictability of changes to DUoS charges. As such, we consider that the proposal better facilitates this objective.

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

The Workgroup assessing DCP136 considered the trade off between facilitating competition through increasing predictability of DUoS charges, and the potential reduction in cost reflectivity which may arise from delays in changing the asset cost inputs.

Our general policy is that charges should be cost reflective as far as is proportionate and practicable. We consider that this change proposal could reduce the cost reflectivity of

¹⁰ The impact of DUoS charge volatility is discussed in Ofgem's 'Decision on measures to mitigate network charging volatility arising from the price control settlement':
<http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=404&refer=Networks/Policy>

charges, but not in a significant way. We note that there are already limits to how these asset costs are reflected in DUoS charges:

- the inputs in the relevant tables are already only updated annually; and
- these inputs have on occasion remained unchanged for several years at a time.

Therefore, we do not think that increasing the notice period for changing these particular inputs to 15 months should have a material effect on the cost reflectivity of charges compared to the status quo.

Some parties raised a concern in their voting comments that the approval of this proposal might delay the proposed implementation (through DCP133) of the new 500MW model. Our decision on DCP136 reflects our assessment of this change against the DCUSA Objectives and our wider duties. While we are aware of the other proposal (DCP133), we will only be able to make our decision on its merits once it has been submitted to us. It would therefore be premature for us to pre-empt our decision on DCP133.

In making our decision, we have considered the objectives of cost reflectivity and promoting competition. In doing so, we have considered the views of parties engaged on this proposal (including those who voted against it). On this occasion, we think that the facilitation of competition in the supply market outweighs the temporary reduction in the cost reflectivity of charges. We have therefore decided to approve this proposal. We consider that this decision is consistent with our decision on measures to mitigate network charging volatility arising from the price control settlements.

Decision notice

In accordance with standard licence condition 22.14 of the Electricity Distribution Licence, the Authority hereby directs that modification proposal DCP136: '*Notice period for asset cost changes in the CDCM*' be made.

Andrew Burgess

Associate Partner, Transmission and Distribution Policy

Signed on behalf of the Authority and authorised for that purpose