

Proposed variation:	<b>Distribution Connection and Use of System Agreement DCP030/ DCP030A – Provision of Cost information</b>		
Decision:	The Authority <sup>1</sup> directs that proposal DCP030 be made <sup>2</sup>		
Target audience:	The Joint Office, Parties to the DCUSA and other interested Parties		
Date of publication:	9 December 2008	Implementation Date:	26 February 2009 scheduled release

## Background to the modification proposal

Suppliers and distributed generators (DG) need to be able to forecast their input costs in order to plan various aspects of their business (pricing strategies, cash management, etc). A key input to these costs is the level of distribution charges. Total distribution charges payable by each supplier will depend on a number of factors including the structure of charges, DNOs' allowed revenue, number of customers and throughput. The DNOs are best placed to forecast their own allowed revenue, as they will have the best insight into their likely performance under the incentive schemes and other operational aspects of the distribution price control.

The fourth price control which runs from 2005 to 2010 introduced a number of new incentives, thus increasing the complexity of allowed revenue calculations. Currently, the DCUSA does not require DNOs to provide regular detailed forecasts of distribution charges, and there are no comparable information requirements arising from the DNOs' licences that the suppliers and DG could utilise.

## The modification proposal

The proposal seeks to provide the detailed information suppliers and DG require in respect of allowed distribution revenue and expected changes to charges for the reasons set out above. The proposal would require DNOs to make the following information available for publication on the publication public area of the DCUSA website on a quarterly basis, for the current year and the subsequent 4 years, based on the DNOs' latest best estimates where the exact figure is not known:

- base demand revenue forecast;
- total pass-through forecast;
- incentive payments forecast;
- correction factor forecast;
- final allowed demand revenue latest;
- final collected revenue forecast;
- forecast over/under-recovery for year, and;
- forecast percentage change to demand use of system charges.

The proposal includes the relevant definitions to underlie the forecast being set out in the DCUSA, and a requirement on the DNOs to provide a commentary where necessary to explain the data and assumptions. It is not the intention of the modification that the information provided by the DNOs will be challenged by interested parties, though reasonable questioning can be expected.

A number of DNOs considered that the level of detail in the change proposal was excessive and an alternative proposal was developed (DCP030A). This had a reduced level of detail

<sup>1</sup> The terms 'the Authority', 'Ofgem' and 'we' are used interchangeably in this document. Ofgem is the Office of the Gas and Electricity Markets Authority.

<sup>2</sup> This document is notice of the reasons for this decision as required by section 49A of the Electricity Act 1989.

than DCP030 but additionally removed the requirement to provide data beyond the current Price Control period.

The proposer of DCP030A considered that the proposed modification would better address the concerns and issues raised in DCP030 in a manner that reflected the nature of the distribution price control.

### DCUSA Parties' recommendation

The Parties have recommended to the Authority that both DCP030 and DCP030A are rejected, as neither achieved more than 50% support from all Party Categories.

The DNOs voted unanimously against DCP030 whilst the IDNOs and suppliers voted unanimously in favour:

DCP030	Weighted Voting (%)					
	DNO		IDNO		SUPPLIER	
	Accept	Reject	Accept	Reject	Accept	Reject
Change solution	0%	100%	100%	0%	100%	0%
Implementation date	58%	42%	100%	0%	100%	0%

There was an overwhelming rejection of the alternative proposal by the suppliers and IDNOs and a rejection by the DNOs as well:

DCP030A	Weighted Voting (%)					
	DNO		IDNO		SUPPLIER	
	Accept	Reject	Accept	Reject	Accept	Reject
Change solution	40%	60%	0%	100%	0%	100%
Implementation date	58%	42%	100%	0%	100%	0%

Notwithstanding their recommended rejection of both DCP030 and DCP030A, an implementation date of February 2009 was recommended.

### The Authority's decision

The Authority has considered the issues raised by the modification proposal and the Final Change Declaration dated 4 November 2008. The Authority has considered and taken into account the responses to the consultation on the modification proposal which are attached to the Change Declaration<sup>3</sup>. The Authority has concluded that:

1. implementation of the change proposal DCP030 will better facilitate the achievement of the applicable objectives of the DCUSA<sup>4</sup>; and
2. directing that the modification be made is consistent with the Authority's principal objective and statutory duties<sup>5</sup>.

<sup>3</sup> DCUSA change proposals, modification reports and representations can be viewed on the DCUSA website at <http://dcusa.co.uk/Public/Default.aspx>

<sup>4</sup> As set out in the Distribution Licence Standard Condition 22.2, see: [http://epr.ofgem.gov.uk/document\\_fetch.php?documentid=14016](http://epr.ofgem.gov.uk/document_fetch.php?documentid=14016)

<sup>5</sup> The Authority's statutory duties are wider than matters which the Panel must take into consideration and are detailed mainly in the Electricity Act 1989.

## Reasons for the Authority's decision

In this letter we first consider whether the provision on a quarterly basis of forecast information pertaining to future allowed revenue and distribution charges better facilitates the achievement of the relevant objectives of the DCUSA and is consistent with the Authority's principal objective and statutory duties. Following this, we then consider which of the two proposals best facilitates the relevant objectives and briefly note the arrangement already in force in the Gas Industry.

We agree with the working group and subsequent respondents to the consultation, that only applicable objective b) is pertinent to this decision.

***Applicable objective b) - The facilitation of effective competition in the generation and supply of electricity and (so far as is consistent therewith) the promotion of such competition in the sale, distribution and purchase of electricity;***

The proposer of DCP030 was of the view that the proposal would facilitate this objective as it would enable suppliers to improve the accuracy of their forecasts and assessments and provide greater certainty of future distribution charges - both within the immediate price control and the subsequent price control. This data will enable suppliers to compete more effectively.

Some DNO respondents felt that this modification did not facilitate competition; one believing it would be neutral at best, and another that it would dampen down, rather than facilitate, competition. This view is based on the fact that differentiation of final pricing between suppliers is a function of many things, including suppliers' different assessments of various future costs. In a market where future costs were all known facts (or highly reliable forecasts) the spread of price offerings to final consumers is likely to be more limited. In addition to this, such markets would be less attractive to potential new entrants, as the scope for their smartness and flexibility to provide a competitive advantage would be much reduced.

These arguments seem to ignore the benefits to suppliers and generators of better information which will enable more informed decision making and enable resources to be better utilised. There are real costs which can be expected to be eliminated (e.g. the costs to suppliers of individually generating their own forecasts or greater costs of price risk insurance where there is greater uncertainty). Eliminating or reducing these costs will be better for customers. Reduced risk for suppliers and DG should also reduce barriers to entry into the supply market and enhance competition.

As another supplier respondent commented "This change will clearly bring improved transparency to this area of the supply market. It can be argued this improves competition as it will allow all suppliers a broadly equal opportunity to forecast future DUoS charges regardless of company size and available analytical resource. Increasing certainty in future Generation DUoS charges is likely also to help facilitate prospective Distributed Generation projects thus improving competition in Generation."

One DNO respondent expressed the view that the debate on the provision of such information is better facilitated as part of the price control or as part of the Structure of Charges project. They noted however, the importance of suppliers getting access to information that will assist them in forecasting future prices.

We agree that the proposals we set out in October for delivering the Structure of Charges project could have been a vehicle for providing this information. However, some DNO companies have objected to our collective licence modification proposals, which are therefore currently on hold. Ofgem could also introduce new licence conditions on the DNOs to provide this information as part of the price control settlement. However, these would only then come

into effect from April 2010. The purpose of this modification is in alignment with the DCUSA objectives and we can see no good reason for delaying the change by bundling it into another project.

Another DNO respondent suggested that the decision on this modification proposal should wait until equivalent arrangements recently introduced into the gas market<sup>6</sup> have been bedded in. This would allow the industry to assess whether the arrangements are of value and will better facilitate the DCUSA objectives. Having considered the costs and risks associated with implementation, these do not seem sufficiently material to delay implementation by adopting a 'wait and see' approach.

We note the concerns of several DNO respondents that the assumptions required for making forecasts beyond the price control period run the risk of producing misleading forecasts on which users may place undue reliance. However, we consider that the primary users are likely to be suppliers, generators and large customers, whose business decisions entail a sophisticated assessment of forecast information on a regular basis and so, providing the assumptions are clearly stated, the risk of undue reliance is low.

It is reasonable to expect that DNOs will be able to provide better long term estimates of their future costs than suppliers and generators can. While the quantum of these costs may not always be certain in advance the DNOs' best attempts to forecast them can provide valuable signals to suppliers and generators that charges can reasonably be expected to rise (or fall).

We note that two respondents replied that if such information is to be provided then the DCUSA website was not the correct forum for publication. DNOs should publish such information in the same way that they publish charging statements, under/over recovery statements, etc. They do not agree that the secretariat of DCUSA should have the obligation to publish such information, nor should they be in a position where they have to chase parties for such information. Whilst we have some sympathy with this view, we do not consider it a significant enough factor to over-ride other considerations.

One DNO respondent also identified that if the implementation leads to lower prices for end users this is a benefit outside the range of the DCUSA objectives. We consider to the extent that lower prices for consumers is an end product of increased competition then it is consistent with the DCUSA objectives.

One DNO respondent expressed concern that such forecasts might prejudice Ofgem's price control decision making process. For the avoidance of doubt, the Authority's decisions are made on the basis of all the evidence available to it. In the case of price controls this includes a review of detailed forecasts made by the licensees and consideration of their supporting arguments and other respondents' views. Thus any high level forecast made under a specific set of assumptions for the purposes of the quarterly reports referred to in this proposal will not prejudice the Authority's decisions.

Some DNO respondents opined that the provision of the extended forecast financial information proposed under DCP030 is commercially sensitive and arguably price sensitive, as it gives information on a Distributor's financial outlook which is either not readily available or is released at different dates to other interested parties. A supplier respondent considered that the data to be published is not commercially sensitive as this relates to regulated businesses whose obligations are determined by the respective licences and the financial arrangements underpinning this are determined by the relevant price control. There was general disagreement upon whether a general release or a case-by-case issue of information should be made.

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<sup>6</sup> [UNC modification 186: 'Provision of cost information'](#)

Most respondents could see no legal reason why this information should not be issued, although one DNO respondent suggested the information would be material at group level and that therefore selective disclosure should be avoided.

We consider that the DCUSA website is an appropriate conduit for publication since the forecasts are of a limited nature issued in furtherance of enhanced understanding and working within the electricity industry. We further consider that the limited forecast information would not be sufficiently informative to render it commercially sensitive, since it shows only revenue forecasts and not costs and returns.

Some DNO respondents were also concerned about the provision of information four times a year, considering this to be onerous and excessive. Other respondents felt that on balance four times was about right and there were a range of suggestions from annually downwards. One respondent expressed the view that providing the information at a lower frequency would not reduce the value to be gained since the long term forecast is unlikely to be revised at each update, and the short term forecast will not change significantly at each quarterly revision. We have sympathy with these views but note that the proposal only calls for reasonable estimates from the DNOs when they update their forecasts quarterly.

We consider that since both proposal DCP030 and alternative proposal DCP030A entail the regular provision of relevant information on revenues and charges to Suppliers, they both better assist the objective of facilitating effective competition. For the reasons outlined above, we also consider that the proposal is consistent with Ofgem's principal objective to protect the interests of consumers, wherever appropriate by promoting effective competition.

Whilst not in itself a precedent for the electricity industry, we also note that UNC modification 186 '*Provision of Cost Information*' provides an example of how the provision of such information has been implemented elsewhere.

#### *Decision between the two variants of the proposal*

Proposal DCP030 provides better information than the alternative proposal DCP030A, because it includes forecasts beyond the end of the price control period, albeit these are based on a set of highly uncertain assumptions. The representations of the Suppliers demonstrate their requirement to have such information even though they recognise it is of limited use. The DNOs' concerns about the potential for such information to be misleading is noted, and the Authority considers that the assumptions need to be carefully considered and clearly stated so that Suppliers understand the basis of these forecasts.

#### **Decision notice**

In accordance with condition 22.14 of the Electricity Distribution Licence the Authority hereby directs that modification proposal DCP030: '*Provision of Cost Information*' be made with effect 26 February 2009.



**Rachel Fletcher,  
Director, Distribution**

Signed on behalf of the Authority and authorised for that purpose.