

Modification proposal:	<b>Distribution Connection and Use of System Agreement (DCUSA) : Proposed move to annual amendment of DUoS charges (DCP001)</b>		
Decision:	<b>The Authority<sup>1</sup> directs that the alternative proposal be made<sup>2</sup></b>		
Target audience:	<b>Parties to the DCUSA and other interested parties</b>		
Date of publication:	<b>22 June 2007</b>	Implementation Date:	<b>Next implementation date, but no earlier than November 2007</b>

### Background to the proposed variation

Currently clause 19.1 of DCUSA allows for Distribution Network Operators (DNOs) and Independent Distribution Network Operators (IDNOs) to make an unlimited number of tariff changes with 40 days notice (unless otherwise specified in the distributors' Relevant Charging Statement) of the actual charges. The electricity distribution licence (the licence) imposes a further obligation on distributors to give three months' notice of tariff changes.

### The proposed variation

This proposed variation seeks to require distributors to use best endeavours to change tariffs no more than once a year, with charges to take effect from 1<sup>st</sup> April.

The Proposer considers that this proposed variation better facilitates the achievement of applicable objectives (a) and (b)<sup>3</sup> of DCUSA:

- (a) The development, maintenance and operation by the licensee of an efficient, co-ordinated and economical distribution system;
- (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 considers that the proposed variation will improve certainty around the DNOs' cashflows and this will result in improved efficiencies for both DNO and IDNO Parties. The Proposer also considers that the proposal will reduce cost and risk by reducing the number of tariff changes and removing uncertainty around the timing of those changes.

### Alternative proposed variations

An alternative proposed variation has been developed by the Working Group (DCP001A). This alternative proposed variation seeks to require distributors to use reasonable

<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.

<sup>3</sup> Standard Condition 9B (9)(a) and (9)(b) of the Distribution Licence.

endeavours to change tariffs no more than twice a year, with charges to take effect from 1<sup>st</sup> April and 1<sup>st</sup> October.

The Working Group considers that this alternative proposal would better facilitate achievement of applicable objective (b) of DCUSA.

### **Recommendation from DCUSA Parties**

#### Proposed variation

DCUSA Parties recommended that the proposed variation be rejected. Of the Party Classes which voted (DNO, IDNO and Supplier), 100% of DNOs and IDNOs and more than 50% of Suppliers voted to reject the proposed variation.

DCUSA Parties also recommended that the alternative proposed variation be rejected. Of the Party Classes which voted, more than 50% of DNOs recommended rejection of the proposed variation and 100% of IDNOs and more than 50% of Suppliers recommended implementation of the proposed variation.

#### Implementation date

DCUSA Parties recommended that the proposed implementation date be rejected for both the proposed variation and the alternative proposed variation.

A full breakdown of the votes for both the proposed variation and the implementation date can be found in the change report.

### **The Authority's decision**

The Authority has considered the issues raised by DCP001 and the final Change Report (CR) dated 18 May 2007. The Authority has considered and taken into account the responses to ElectraLink's<sup>4</sup> consultation which are attached to the CR<sup>5</sup> and the recommendation of the DCUSA parties. The Authority has concluded that:

1. implementation of the alternative proposed variation, DCP001A proposed by the Working Group will better facilitate the achievement of the Applicable DCUSA Objectives<sup>6</sup>; and
2. directing that the alternative proposed variation proposed by the Working Group be made is consistent with the Authority's principal objective and statutory duties<sup>7</sup>.

### **Reasons for the Authority's decision**

Some DNO Parties have said that restricting tariff changes may impact their ability to effectively discharge their licence obligations. The DNOs have a licence obligation to use

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<sup>4</sup> The role, functions, and responsibilities of Electralink are set out in Section 1B of the DCUSA.

<sup>5</sup> DCUSA proposed variations, modification reports and representations can be viewed on the ElectraLink website at [www.electralink.co.uk](http://www.electralink.co.uk)

<sup>6</sup> As set out in The Distribution Licence Standard Condition 9B, see: [http://195.12.224.140/document\\_fetch.php?documentid=8378](http://195.12.224.140/document_fetch.php?documentid=8378)

<sup>7</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.

best endeavours to set charges such that they do not over-recover against allowed revenue. This means that when setting tariffs DNOs shouldn't aim to over-recover relative to allowed revenue.

DNOs are also subject to an incentive to set charges to recover allowed revenue. The incentive mechanism penalises them if they over or under recover outside of set tolerance limits. Many DNO Parties have said that they need flexibility in relation to tariff changes to ensure that they can meet these requirements.

Some DNO Parties have also said that restricting the number of tariff changes per year may affect their ability to develop economic and efficient networks as they may not be able to reflect cost changes immediately in prices. It is argued that changes in cost need to be reflected to customers to ensure that they make appropriate decisions about their use of the distribution network.

Many Supplier Parties have argued that multiple tariff changes each year by each of distributors, increases risk and costs to suppliers. Restricting the number of tariff changes and aligning the timing of those changes across distributors will likely reduce cost to suppliers and therefore reduce barriers to entry in the supply market, promoting effective competition.

One Supplier Party indicated that they would prefer multiple tariff changes per year rather than one or two significant changes. For the sector that they supply, contract sales renewals occur throughout the year rather than been concentrated around 1<sup>st</sup> April. They consider that more frequent, smaller tariff changes throughout the year impose less risk compared with one or two more significant tariff changes.

In recent years the DNOs have generally changed tariffs no more than twice a year. The timing of mid-year tariff changes however has not been consistent across the DNOs.

Considering the points made above, on balance it is our view that the alternative proposed variation would better facilitate applicable objective (b) of DCUSA by facilitating effective competition in the supply of electricity as it will reduce the unpredictability of timing of tariff changes across distributors, thereby reducing cost and risk to suppliers.

We do not consider DCP001A will be detrimental to applicable objective (a) of the DCUSA. Distributors are required under the licence to give three months' notice of tariff changes which has tended to restrict the number of changes that they make. In practice, cost changes are not reflected in prices immediately. We do not consider that the alternative proposed variation impacts distributors' ability to develop an economic and efficient distribution system.

It is considered that the alternative proposed variation still provides distributors with sufficient flexibility to meet their licence obligations and therefore provides for the efficient discharge of their licence obligations. We therefore do not consider DCP001A will be detrimental to applicable objective (c) of the DCUSA.

The alternative proposed variation includes an implementation date of "the next implementation date after the Authority's consent but no earlier than the November 2007 implementation date". We note that the DCUSA provides for subsequent amendment to the implementation date by representation from any Party to the Authority. The

Authority, having first consulted with the Panel, may direct that a new implementation date be substituted.<sup>8</sup>

**Decision notice**

**In accordance with Standard Condition 9B (Part D) of the Distribution Licence, the Authority, hereby directs that the alternative proposed variation DCP001A: Proposed move to annual amendment of DUoS charges be made, and that it shall be implemented on the next implementation date, but no earlier than November 2007.**



**Martin Crouch**  
**Director, Electricity Distribution**

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

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<sup>8</sup> Clause 14.7 and 14.8 of DCUSA.