

DCUSA Change Report		At what stage is this document in the process?
<h1 data-bbox="124 353 550 448">DCP 306</h1> <h2 data-bbox="116 504 1093 649">Treatment of Ofgem Licence Fees within the PCDM</h2> <p data-bbox="116 678 786 719"><i>Raised on 12 July 2017 as a Standard Change</i></p>	01 – Change Proposal	
	02 – Consultation	
	03 – Change Report	
	04 – Change Declaration	
<p><b>Purpose of Change Proposal:</b></p> <p>DCP 306 seeks to increase the cost reflectivity of the Price Control Disaggregation Model by directly allocating the Ofgem Licence Fee to an appropriate network tier for the calculation of the Opex allocation driver.</p>		
	<p>This document is issued in accordance with Clause 11.20 of the DCUSA, and details DCP 306 – ‘Treatment of Ofgem Licence Fees within the PCDM’.</p> <p>Parties are invited to consider the proposed amendment (Attachment 1) and submit their votes using the Voting form (Attachment 2) to <a href="mailto:dcusa@electralink.co.uk">dcusa@electralink.co.uk</a> by <b>14 May 2018</b>.</p> <p>The voting process for the proposed variation and the timetable of the progression of the Change Proposal (CP) through the DCUSA Change Control Process is set out in this document.</p> <p>If you have any questions about this paper or the DCUSA Change Process, please contact the DCUSA by email to <a href="mailto:dcusa@electralink.co.uk">dcusa@electralink.co.uk</a> or telephone 020 7432 3011.</p>	
	<p>Parties Impacted: <b>Distribution Network Operators (DNOs), Independent Distribution Network Operators (IDNOs)</b></p>	
	<p>Impacted Clauses:</p> <p>Schedule 29, Clause 6 table and a new paragraph 11A</p>	

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Any questions?

Contact:

**Code Administrator**



**DCUSA@electralink.co.uk**



**020 7432 3011**

Proposer: **The Electricity Network Company Ltd.**



**Neil.Brinkley@bu-uk.co.uk**



**01359 302451**

## Timetable

The timetable for the progression of the CP is as follows:

### Change Proposal timetable

Activity	Date
Initial Assessment Report Approved by Panel	19 July 2017
First Consultation issued to Parties	18 September 2017
Methodology Pack issued to Reckon	01 November 2017
Reckon to develop model for PCDM	16 November 2017
Second Consultation issued to Parties	26 January 2018
Change Report issued to Panel	11 April 2018
Change Report issued for Voting	20 April 2018
Party Voting Ends	14 May 2018
Change Declaration Issued to the Authority	16 May 2018
Authority Decision	21 June 2018
Implementation	01 April 2020

## 1 Summary

### What?

- 1.1 The Distribution Connection and Use of System Agreement (DCUSA) is a multi-party contract between electricity Distributors and electricity Suppliers and large Generators. Parties to the DCUSA can raise Change Proposals (CPs) to amend the Agreement with the consent of other Parties and (where applicable) the Authority.
- 1.2 This CP seeks to improve the cost reflectivity of Opex cost allocation within the Price Control Disaggregation Model (PCDM) (part of Schedule 16<sup>1</sup>) by allocating Ofgem licence fee costs directly to an appropriate network tier.

### Why?

- 1.3 Currently, the Ofgem licence fee is calculated and paid by distributors on a £ per MPAN basis. The licence fee costs are not presently considered within the PCDM in calculating the Opex cost allocation driver. It is the view of the Proposer that the costs associated with the Ofgem licence fee are not correctly allocated, leading to the Licenced Distributor Network Operator (LDNO)<sup>2</sup> tariffs being less cost reflective, particularly for Low Voltage (LV) connected end user LDNO tariffs (High Voltage (HV):LV, LV:LV etc.)

### How?

- 1.4 To allocate the Ofgem licence fee (taken from 2007/08 Regulatory Reporting Pack table 2.6) to the LV services network level and treated as indirect costs within the PCDM.

## 2 Governance

### Justification for Part 1 Matter

- 2.1 DCP 306 has been designated as a Part 1 Matter as the proposed change potentially impacts on both 9.4.1 and 9.4.2 of DCUSA.
- 9.4.1 – it is likely to have a significant impact on the interests of electricity consumers; and
  - 9.4.2 – it is likely to have a significant impact on competition in distribution.

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<sup>1</sup> Since this CP was raised, DCP 234 'merging the PCDM and the Extended PCDM' has been approved resulting in the PCDM being relocated into a new schedule 29 with effect from the 1<sup>st</sup> April 2018.

<sup>2</sup> An IDNO Party or DNO Party operating an electricity distribution system outside of its Distribution Services Area.

2.2 DCP 306 has been designated as a standard change.

### Requested Next Steps

2.3 The Panel considered that the Working Group have carried out the level of analysis required to enable Parties to understand the impact of the proposed amendment and to vote on DCP 306.

2.4 The DCUSA Panel recommends that this CP:

- Be issued to Parties for Voting.

## 3 Why Change?

### Background of DCP 306

3.1 The Proposer suggests that the costs associated with the Ofgem licence fee are payable by all LDNOs but the derivation of the LDNO tariffs does not fully include this cost. Consequently, it is believed that LDNOs are not able to fully recover the costs incurred, or reasonably expected to be incurred in operating their distribution businesses.

3.2 As the Opex cost allocation driver does not take into account the Ofgem licence fee, the costs associated with the Ofgem licence fee are effectively smeared across all network levels. The resultant LDNO tariffs are not, therefore, reflective of the costs incurred by the LDNO.

3.3 This CP seeks to ensure that the LDNO tariffs better reflect the costs that are avoided by the DNO when customers are connected to their network via another LDNO.

3.4 The Proposer suggests that by allocating the Ofgem licence fee to the LV services network level, the LDNO tariffs produced by the Common Distribution Charging Methodology (CDCM) will better reflect the mechanism by which these costs are incurred. This is consistent with the purpose of the PCDM and DCUSA Charging Objective 3. The change proposal is contained within Attachment 3.

## 4 Solution

### DCP 306 Assessment

4.1 The DCUSA Panel established a Working Group to assess DCP 306. This Working Group consists of DNO and IDNO representatives and an Ofgem observer. Meetings were held in open session and the minutes and papers of each meeting are available on the DCUSA website – [www.dcusa.co.uk](http://www.dcusa.co.uk).

4.2 DCP 306 was raised by The Electricity Network Company and seeks to put greater clarity in place for the allocation of the Ofgem licence fee within the PCDM. Currently, Ofgem the licence fee forms part of residual charges when calculating the CDCM tariffs and as such is not a separate cost

element within the PCDM. This change will be looking to review the impacts of changing this, i.e. allocating the licence fee either by, as the Proposer suggest, a 100% allocation to the LV service level or alternatively allocated across each voltage level within the PCDM. All other aspects of Opex would be unchanged.

- 4.3 The Working Group considered how the licence fee is currently derived and then subsequently allocated with the CDCM. It was determined that Ofgem charge each DNO a licence fee on a £/MPAN basis. This is then recovered as part of the residual charging calculation when deriving the all the way tariffs in the CDCM. It was confirmed that since the change is in the PCDM there would be no impact on the all the way tariffs and as such no impact on end customers connected directly to the host DNO network, other than any resulting indirect impact on the recover of the residual charge.
- 4.4 The Working Group considered whether a more appropriate change would be to the CDCM by taking the licence fee out of residual charges and within the methodology itself. This was discounted since it would not align with the intent.
- 4.5 The timing of the change was questioned as, on 4 August 2017 Ofgem launched a Targeted Charging Review (TCR) Significant Code Review (SCR). One of the key areas within the TCR covers residual charging. It was discussed whether it would be more practicable to progress the proposed change as part of the wider CDCM review or as part of the TCR.
- 4.6 It was decided that as the change is specifically looking at the PCDM, the Working Group would not be able to include CDCM or EHV Distribution Charging Model (EDCM) amendments in their solutions as it would change the intent of the proposal. Therefore, there shouldn't be any impact on the TCR.
- 4.7 The Working Group then considered whether the allocation within the PCDM should only be applied to the LV network level and whether it may be even more cost reflective if the allocation of the licence fee was placed against each network level. The Working Group agreed that they would seek the views of Parties on this matter to help define the solution. Industry views and Working Group conclusions can be found below.
- 4.8 The Proposer is suggesting that the costs described in table 2.6 of the 2007/08 Regulatory Reporting Pack (RRP) as "Ofgem licence fee" be used. The reasoning for this is that it matches the rest of the data source being used within the PCDM. A counter argument was that it may be more cost reflective to use the latest licence fee costs rather than the ones that are ten years old. The Working Group were of the view that for consistency the 2007/08 RRP should be used as it aligns with how the rest of the operational costs have been allocated within the PCDM.

### **DCP 306 First Consultation**

- 4.9 To aid further development of the solution for this CP, the Working Group issued a consultation to Parties on 18 September 2017 (Attachment 4). The Working Group issued the consultation to DCUSA Contract Managers and Ofgem to gather Party opinion on:

- Whether the TCR or CDCM review work is a more appropriate work stream to review this issue;
- Is it more appropriate to allocate the licence fee at each voltage level or just at the LV network level; and
- Whether the data on customer numbers at each voltage level is easily identified.

4.10 There were six responses received to the consultation. Four respondents were Distribution Networks Operators and two respondents were Independent Distribution Network Operators. The Working Group discussed each response and its comments are summarised alongside the collated consultation responses in Attachment 4.

4.11 All respondents agreed that they understood and agreed with the principles and intent of the change. However, one DNO respondent highlighted that they did not agree with how the Proposer suggests that the Ofgem licence fee for a DNO are determined by MPANs.

4.12 The Working Group accepted the comments made by the DNO on how the costs are produced by Ofgem, however, the CP is looking at allocating the Ofgem licence fee on a £/MPAN basis which is moving from a fixed cost to unit cost method and is not a like for like for what currently happens. Although the Working Group acknowledged the comments made by the respondent, the Working Group view was to continue with the original principles of the change as they believe the solution will provide better cost reflectivity.

4.13 Respondents highlighted that the Working Group would need to be cautious about the outputs from Ofgem's Charging Future's Forum (CFF) and their subsequent Task Forces that have been organised. The Working Group recognised that the change is in the gift of the Proposer and unless directed otherwise by the Authority the CP will progress since the change impacts the PCDM and not the CDCM.

4.14 Regarding the question on how the Ofgem licence fee should be allocated within the PCDM and whether it should be at LV voltage level or be allocated at each voltage level based on the number of customers connected at each, the majority of respondents wanted to allocate the Ofgem licence fee at various voltage levels.

4.15 All respondents believed that the 2007/08 data set was the best data set to use for this change as it would be consistent with the rest of the PCDM. However, it was highlighted that the industry may need to consider a wider review in the future.

## Working Group Conclusions

4.16 The Working Group identified two areas of further work having discussed the responses within the consultation:

- Review of papers submitted to the CFF; and

- Identify the number of customers at each voltage level in order to determine whether it is more appropriate to allocate the Ofgem licence fee at each voltage level or just at the LV network level.

4.17 The Working Group agreed with the Parties' response relating to the use of 2007/08 data

4.18 On the first areas of further work, Ofgem issues two paper in advance of the CFF:

- [Targeted Charging Review working paper](#), and
- [Reform of electricity network access and forward-looking charges](#).

4.19 The Working Group reviewed both papers and discussed whether the work would be better if the intent of this change is reviewed as part of Ofgem's TCR or the CFF and one of its task forces.

4.20 The Working Group highlighted that the TCR is reviewing residual charges, while the task forces will be covering forward-looking charges and access arrangements. As the Working Group are solely focussing on the PCDM, there is no direct interaction between this proposal and the TCR. Therefore, unless the Working Group are given direction from Ofgem to put the proposal on hold, they decided to continue to discuss the solution via the DCUSA change process.

4.21 On the second area, Parties supported the allocation of the licence fee at each voltage level from a cost reflectivity perspective. In order to develop this, the Working Group requested from the DNO community the number of customers at each voltage level. When this was analysed there were 99.8% of customers forecast to be connected at the LV network level. The Working Group concluded that from a pragmatic point of view it may be sensible to allocate at the LV network level rather than at each voltage level. This would reduce cost reflectivity (but likely to be immaterial) but improve simplicity.

## DCP 306 Second Consultation

4.22 The Working Group issued a second consultation to industry to seek views on the rationale used to determine that the licence fee should only allocated to the LV network level, views on the proposed legal text, DCUSA Charging Objectives and the decision to continue to assess the change via the DCUSA change process and not the SCR, CFF or wider task forces.

4.23 There were nine responses to the second consultation and these comprised of six DNOs and three IDNOs. Responses to the second consultation and Working Group conclusions can be found below and within Attachment 5.

**Question 1: Are Parties comfortable with the approach proposed by the Working Group to allocate the Ofgem licence fee to the LV service customers rather than allocating them across all voltage levels? If not, provide your rationale.**

- 4.24 Eight responses to this question agreed that they were happy with the approach to allocate the Ofgem licence fee to LV service customers following on from the rationale provided by the Working Group.
- 4.25 However, one DNO respondent did not agree with the approach and they had concerns on the accuracy, the cost driver and the risk of “cherry-picking”. The Working Group recognised the response from the DNO and highlighted that the topics they had raised had already been discussed thoroughly after the first consultation and in previous Working Group meetings.

### **Question 2: Do you have any comments on the proposed legal text?**

- 4.26 The majority of respondents to this consultation question agreed that they were happy with the current drafting of the proposed legal text.
- 4.27 There was a minor suggestion to amend “Ofgem Licence Fees” to “Ofgem Licence Fee” to be consistent with the RRP. The Working Group welcomed this change and updated the legal text to reflect this.
- 4.28 A DNO response also suggested a formatting change to the legal text. The Working Group decided that they were happy with the current drafting and decided not to change the drafting as there were no material changes in the suggestions.

### **Question 3: Which of the DCUSA Charging Objectives are better facilitated by this change? Please provide your rationale.**

- 4.29 The majority of respondents believed that DCUSA Charging Objective three would be better facilitated by this change. More detail on the objectives can be found in section 5 below.

### **Question 4: Do you agree that the change should continue to be assessed via the DCUSA Change Process and not the SCR, CFF or wider Task Forces?**

- 4.30 The majority of respondents agreed that the changes should continue to be assessed via the DCUSA change process and highlighted that they were aware that it would be the proposer’s decision to withdraw the change if they wished to do so.

### **Question 5: Do you have any other comments for the Working Group?**

- 4.31 All respondents highlighted that they did not have any further comments for the Working Group.

### **Working Group Conclusions**

- 4.32 Following on from the responses to the second consultation, the Working Group decided that they still wanted to continue with the proposed solution of allocating the Ofgem Licence Fee to the LV service customers only. It was noted that the change is looking at allocating on a £/MPAN basis

which would be moving from a fixed cost to a unit cost method which provides slightly better cost reflectivity than it does currently.

4.33 The Working Group also concluded that they are going to be continuing to progress DCP 306 via the DCUSA Change Process. They are aware that there could be potential overlap with the work being conducted by Ofgem’s CFF and task forces, however, the areas of work are still being discussed and LDNO discounts have not yet been identified as an area of concern. It is the Working Group’s view that there are too many unknowns within the work being undertaken by the CFF and task forces to prevent DCP 306 progressing.

## 5 Relevant Objectives

### Assessment Against the DCUSA Objectives

5.1 For a DCUSA Change Proposal to be approved it must be demonstrated that it better meets the DCUSA Objectives. There are five General DCUSA Objectives and six Charging Objectives. This change proposal impacts the charging objectives.

Impact of the Change Proposal on the Relevant Objectives:	
Relevant Objective	Identified impact
Charging Objective One – 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
Charging Objective Two – 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)	Neutral
Charging Objective Three – 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
Charging Objective Four – that, so far as is consistent with Clauses 3.2.1 to 3.2.1, the Charging Methodologies, so far as is reasonably practicable, properly take account of developments in each DNO Party’s Distribution Business	Neutral
Charging Objective Five - that compliance by each DNO Party with the Charging Methodologies facilitates compliance with the Regulation on Cross-Border Exchanges in Electricity and any relevant legally binding decisions of the European Commission and/or the Agency for the Co-operation of Energy	Neutral

Regulator	
Charging Objective Six - that compliance with the Charging Methodologies promotes efficiency in its own implementation and administration.	Neutral

- 5.2 The Working Group unanimously considers that **Charging Objective Three** is better facilitated by DCP 306 because this change provides for a more cost reflective mechanism for the allocation of the Ofgem licence fee.
- 5.3 The Working Group acknowledged that whilst allocating the licence fee at each voltage level would be the most cost reflective approach, the Working Group do not believe that the incremental benefit of allocating at each voltage level will outweigh the added complexity given 99.8% of customers were forecasted to be connected at the LV network. The proposed change will therefore improve cost reflectivity.
- 5.4 The Working Group unanimously considers that the rest DCUSA Charging Objectives are neutral as a consequence of this change proposal.

## 6 Impacts & Other Considerations

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

- 6.1 Having considered the views from some respondents that the Change Proposal may be better suited under Ofgem’s Charging Futures Forum (CFF) work the Working Group decided that the CFF and Task Forces are still to agree on its scope of work and therefore would want to continue with progressing the change under the DCUSA Change Process.

### Consumer Impacts

- 6.2 The Working Group requested that the DCUSA Modeller conduct an update on the PCDM to reflect the impacts on the consumer and LDNO tariff when allocating the Ofgem licence fee to LV voltage customers.
- 6.3 The impact assessment on the end user tariffs showed that there was a positive difference of between +0.01% and +0.17% on the Unit Rate 1 (p/kWh) tariffs for all DNO areas. There was also a small difference between +0.01% and +0.18% for the fixed charge for some of the DNO area.
- 6.4 The Working Group also noted that the impact assessment on the LDNO tariffs showed that there were both positive and negative effects on all DNO areas when allocating the Ofgem licence fee to LV service level customers.
- 6.5 These effects ranged from -2.38% to +1.41% on the unit rate 1 (p/kWh) tariffs for all DNO area and -3.70% to +1.16% on the fixed charge tariffs for all DNO areas when allocating the Ofgem licence fee to LV service level customers.

6.6 The following outcomes also came from the modelling update:

- DCP 306 would increase discount percentages for LV end-user demand and reduce (or leave unchanged) discount percentages in all other cases.
- The largest impact is on discount percentages for LV end-user demand with a LV LDNO boundary. For this configuration, the increase in discount percentages caused by DCP 306 would range from 0.22 percentage points to 0.51 percentage points.
- For LV end-user demand with a HV or HV plus LDNO boundary, the increase in discount percentages caused by DCP 306 would range from 0.05 percentage points to 0.31 percentage points.
- The largest reduction in discount percentages caused by DCP 306 is 0.12 percentage points this is for HV end user demand with a HV plus LDNO boundary in the Northern Powergrid Northeast area.
- There are some small increases (up to 0.27 percent) to CDCM end user tariffs in all DNO areas.

6.7 In summary, the majority of the end user tariffs are unaltered, and those that are, in the main result in 0.01p/kWh increase in the unit rate and a 0.001p/MPAN/day increase in the fixed charge rate. The full impact assessment can be found as attachment 6.

## Environmental Impacts

6.8 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 306 were implemented. The Working Group did not identify any material impact on greenhouse gas emissions from the implementation of this CP.

## Engagement with the Authority

6.9 Ofgem has been fully engaged throughout the development of DCP 306 as an observer on the Working Group.

# 7 Implementation

7.1 The proposed implementation date for DCP 306 is 01 April 2020.

# 8 Legal Text

8.1 The DCP 306 proposed legal text acts as Attachment 1 to this Change Report.

- 8.2 The proposed legal text amends the new Schedule 29 by amending the Paragraph 6 Table: 'Allocation Rules' and includes a new paragraph 11A.
- 8.3 The 'Allocation Key' and the 'Direct Cost Indicator' in the Allocation Rules table for 'Non activity costs and reconciling amounts' now refers to the new Paragraph 11A.
- 8.4 Paragraph 11A states that the only costs associated with 'Non-activity costs and reconciling amounts' that will be directly allocated are the costs described in table 2.6 of the 2007/2008 RRP as "Ofgem licence fee" and they shall be 100% allocated directly to the LV services level and treated as indirect costs.

## 9 Code Specific Matters

### Modelling Specification Documents

- 9.1 The PDCM has been updated as a consequence of this change. See Attachment 6.

### Reference Documents

- 9.2 Not applicable.

## 10 Recommendations

### Panel's Recommendation

- 10.1 The Panel approved this Change Report on 18 April 2018. The Panel considered that the Working Group had carried out the level of analysis required to enable Parties to understand the impact of the proposed amendment and to vote on DCP 306.
- 10.2 The Panel have recommended that this report is issued for Voting and DCUSA Parties should consider whether they wish to submit views regarding this Change Proposal.

### Attachments

- Attachment 1 – DCP 306 Legal Text
- Attachment 2 – DCP 306 Voting Form
- Attachment 3 – DCP 306 Change Proposal
- Attachment 4 – DCP 306 First Consultation and Collated Responses
- Attachment 5 – DCP306 Second Consultation and Collated Responses
- Attachment 6 – DCP 306 PDCM Model and Impact Assessment