

Proposed modification:	Distribution Connection and Use of System Agreement (DCUSA) DCP117 – Treatment of 'Load related new connections & reinforcement (net of contributions)' in the Price Control Disaggregation Model		
Decision:	The Authority ¹ directs this modification ² be made ³		
Target audience:	DCUSA Panel, Parties to the DCUSA and other interested parties		
Date of publication:	22 July 2015	Implementation date:	1 April 2016

Background

The distribution network operators (DNOs) operate 14 distribution service areas (DSAs). Independent distribution network operators (IDNOs) can own and operate smaller networks in the DSAs and provide competition for some of the distribution network activities. The charges the IDNOs pay to DNOs for use of their distribution networks are discounted to reflect the fact that IDNOs provide the 'last mile' of the distribution network. The discount factors are calculated in the Price Control Disaggregation Model (PCDM).

The PCDM calculates a percentage split between direct and indirect costs. This split is used to allocate costs between the DNO and the IDNO at the network level where the IDNO assets connect to the DNO network. Currently, the PCDM uses data in the 'RRP⁴ 2.4' worksheet to allocate 'load related new connections & reinforcement (net of contributions)' costs ("total connection costs") to network tiers. However, customer contributions are not split by tier and instead are allocated entirely to the low voltage (LV) level. This means direct costs at LV are reduced by customer contributions, which should be allocated to the high voltage (HV) level.

Some parties believe the way that total connection costs are calculated and allocated to network tiers results in a distortion in the calculation of the direct/indirect cost split in favour of the upstream DNO.

In June 2011, the Electricity Network Company raised DCP094⁵, which proposed to remove total connection costs from the calculation of the direct/indirect cost split at the HV and LV tiers. On 9 December 2011, we published our decision to reject DCP094.⁶ We did not consider that the DCP094 working group had provided sufficient evidence for us to conclude that the proposal better met the relevant charging objectives. We suggested that it should be resubmitted so the working group could carry out further analysis of the cost reflectivity of the proposed solution compared to the status quo.

The modification proposal

DCP117 was raised by GTC on behalf of the Electricity Network Company and is essentially a resubmission of DCP094, but with a broader scope to allow alternative solutions to be considered.

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

³ This document is notice of the reasons for this decision as required by section 49A of the Electricity Act 1989.

⁴ Regulatory Reporting Pack

⁵ *Treatment of 'load Related new connections & reinforcement (net of contributions)' in the Price Control Disaggregation Model used to determine LDNO discount factors*

⁶ https://www.ofgem.gov.uk/sites/default/files/docs/2011/12/dcp094d1_0.pdf

The working group's final solution uses data from the 'FBPQ LR1' worksheet⁷ in the PCDM to calculate total connection costs net of customer contributions at each network tier. Customer contributions identified as relating to indirect costs are not allocated to the network tiers but contribute towards the direct/indirect cost split. Customer contributions in excess of the total connection costs allocated to each network tier are not considered.

DCUSA Parties' recommendation

The Change Declaration for DCP117 indicates that all parties were eligible to vote on DCP117. In each party category where votes were cast, there was unanimous support for the proposal and for its proposed implementation date. In accordance with the weighted vote procedure, the recommendation to the Authority is that DCP117 is accepted. The outcome of the weighted vote is set out in the table below:

DCP117	WEIGHTED VOTING (%)							
	DNO ⁸		IDNO/OTSO ⁹		SUPPLIER		DG ¹⁰	
	Accept	Reject	Accept	Reject	Accept	Reject	Accept	Reject
CHANGE SOLUTION	100	0	100	0	n/a	n/a	n/a	n/a
IMPLEMENTATION DATE	100	0	100	0	n/a	n/a	n/a	n/a

Our decision

We have considered the issues raised by the proposal and the Change Declaration and Change Report dated 17 June 2015. We have considered and taken into account the vote of the DCUSA Parties on the proposal which is attached to the Change Declaration. We have concluded that:

- implementation of the modification proposal will better facilitate the achievement of the DCUSA Charging Objectives;¹¹ and
- directing that the modification be made is consistent with our principal objective and statutory duties.¹²

Reasons for our decision

We consider this modification proposal will better facilitate DCUSA Charging Objectives 3.2.1, 3.2.2 and 3.2.3 and has a neutral impact on the other relevant objectives.

DCUSA Charging Objective 3.2.1 – 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

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)

⁷ Forecast Business Plan Questionnaire

⁸ Distribution Network Operator

⁹ Independent Distribution Network Operator/Offshore Transmission System Operator

¹⁰ Distributed Generation

¹¹ The DCUSA Charging Objectives (Relevant 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.

¹² The Authority's statutory duties are wider than matters that the Parties must take into consideration and are detailed mainly in the Electricity Act 1989 as amended

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 working group considered that these objectives are better facilitated because the modification corrects a perceived defect, which means that currently the charge to the downstream IDNO is not cost reflective because it does not take into account all customer contributions. This can result in margin squeeze for the IDNOs, which the working group considered could have a negative effect on competition.

We agree that allocating total customer contributions is more cost reflective than the current arrangements. Therefore, we agree with the working group that charging objectives 3.2.1 and 3.2.3 are better facilitated by DCP117. In particular, we agree with the proposer's view that all customer contributions should be taken into account where possible. The changes proposed by DCP117 should result in a more direct/indirect cost split and better cost reflectivity.

More cost reflective charges should improve competition by reducing potential distortions in the way the PCDM calculates IDNO discounts. Therefore, we also agree that DCP117 better facilitates charging objective 3.2.2, which sets out that the charging methodologies will not restrict, distort or prevent competition.

We previously rejected DCP094 on the basis that insufficient evidence was provided to conclude that it was more cost reflective with respect to the impact at the HV tier. In particular we noted that data on the correct allocation of customer contributions and reinforcement costs was not available. The solution proposed by DCP117 addresses the previous issue of data being unavailable by using customer contributions from the data in the 'FBPQ LR1' worksheet, which can be allocated by network tier. The 'FBPQ LR1' worksheet is already used to determine the MEAV¹³ cost driver in the PCDM.

We note the revenue DNOs will no longer receive from IDNOs, due to the change in the discount percentages, will be smeared across all other CDCM customers. The results of the impact assessment issued with the October 2014 consultation indicate that there will only be very small increases of around 0.001p/kWh in unit rates and 0.01p/MPAN¹⁴/day in fixed charges for affected consumers. We consider the improvement in cost reflectivity and resulting competition benefits outweigh these very small increases to consumers.

Decision notice

In accordance with standard licence condition 22.14 of the Electricity Distribution Licence, the Authority hereby directs that modification proposal *DCP117: Treatment of 'Load related new connections & reinforcement (net of contributions)' in the Price Control Disaggregation Model* be made.

Ian Rowson

Associate Partner – Regulatory Finance and Compliance

Signed on behalf of the Authority and authorised for that purpose

¹³ Modern Equivalent Asset Value

¹⁴ Meter Point Administration Number