



Change Declaration

DCP 266 'The calculation and application of IDNO discounts'

Voting end date: 8 November 2019

DCP 266	WEIGHTED VOTING				
	DNO	IDNO	SUPPLIER	CVA REGISTRANT	GAS SUPPLIER
CHANGE SOLUTION	Accept	Reject	No Votes Received	Not Eligible	Not Eligible
IMPLEMENTATION DATE	Accept	Reject	No Votes Received	Not Eligible	Not Eligible
RECOMMENDATION	<p>Change Solution – Reject.</p> <p>In accordance with Clause 13.5, for Parties to have been deemed to recommend to the Authority that the change solution be Accepted there needs to be a majority of Party Categories whose votes to accept, when summed together, equate to more than 50% of the total votes of Parties or Groups within in each category.</p> <p>In the case where only two Party Categories vote on a Change Proposal, and one Category votes to accept and the other votes to reject, there can be no such majority and therefore, in accordance with Clause 13.5, the Parties have been deemed to recommend to the Authority that the change solution be Rejected.</p> <p>Implementation Date – Reject.</p> <p>In accordance with Clause 13.5, for Parties to have been deemed to recommend to the Authority that the implementation date be Accepted there needs to be a majority of Party Categories whose votes to accept, when summed together, equate to more than 50% of the total votes of Parties or Groups within in each category.</p> <p>In the case where only two Party Categories vote on a Change Proposal, and one Category votes to accept and the other votes to reject, there can be no such majority and therefore, in accordance with Clause 13.5, the Parties have been deemed to recommend to the Authority that the implementation date be Rejected.</p>				
PART ONE / PART TWO	Part One – Authority Determination Required				

PARTY	SOLUTION (A / R)	IMPLEMENTATION DATE (A / R)	WHICH DCUSA OBJECTIVE(S) IS BETTER FACILITATED?	COMMENTS
DNO PARTIES				
Electricity North West Limited	Reject	Accept	We do not believe any DCUSA Objectives are better facilitated by this change. Our views on this change are summarised in the next section.	<p>We do not believe the mathematical logic defect identified by the proposer of this change exists. It is our view that the methodology as currently drafted correctly reflects the intent of the Authority in allocating All-The-Way revenues using a reasonable apportionment of total costs.</p> <p>Furthermore, we have a significant concern about the impact of this change on competition in the distribution of electricity.</p> <p>The proposed change increases the number of tariffs capped at 100% by a factor of 20. Under the current methodology capping is applied only at the highest few voltage levels, and only in certain DNO areas. Under the proposed approach capping would be far more commonly applied, including at lower voltage levels than before.</p> <p>The effect of such wide scale capping is that businesses competing with DNOs cannot earn any additional margin by providing services at voltage levels above the voltage level where the 100% cap first applies. This change would therefore prevent consumers from benefitting from a competitive market in distribution, and potentially lower costs in the long term, at those voltage levels.</p>

Northern Powergrid (Northeast) Ltd	Accept	Accept	We consider that charging objectives two and three are better facilitated by this change.	
Northern Powergrid (Yorkshire) plc	Accept	Accept	The change will result in the margin available to an IDNO reflecting an appropriate allocation of revenues between the DNO and IDNO based entirely on the analysis of DNO costs carried out in the PCDM. In so doing, we consider that competition in the distribution of electricity will be improved (charging objective two), and that the DNO charges to IDNOs will more accurately reflect the costs incurred by the DNO in its distribution business (charging objective three).	
Eastern Power Networks	No vote	No vote		<p>We have participated in the DCUSA working group for this change proposal, and we are of the view that the proposal brought forward to align the approach for the calculation of ATW and IDNO charges is a sensible one. However we have significant concerns with regards to progressing this change at this time, whilst the work being taken forward under the Significant Code Review (SCR) being led by Ofgem on Forward Looking Charges is still being developed. This SCR is expected to consider the wider charging area including those of IDNOs, so we believe that the approach considered by this change would be more appropriate to consider within that review, in order to understand if it could form part of the enduring solution delivered by the SCR. The proposed implementation date of DCP266 is 1 April 2023, which is the same as when the changes are expected to be seen from the SCR, as a result no additional delay would be seen by not taking forward these changes under DCP266 in isolation.</p> <p>As a result of the above, we are not in a position to vote to either accept or reject this change</p>
London Power Networks	No vote	No vote		
South Eastern Power Networks	No vote	No vote		

				proposal, so we have taken the decision to abstain from voting in relation to DCP266.
Southern Electric Power Distribution plc	Accept	Accept	Possibly DCUSA Objective 2: however, we do not believe that the change demonstrably better facilitates any of the DCUSA Objectives.	-
Scottish Hydro Electric Power Distribution plc	Accept	Accept		

IDNO PARTIES

The Electricity Network Company Limited & Independent Power Networks Limited	Reject	Reject	<p>We do not believe that it has demonstrated that the change proposal as proposed better meets any of the DCUSA charging objectives. Below, we set out our reasons against each of the charging objectives</p> <p>Charging Objective 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.</p> <p>The proposal and change report are barely coherent despite the various attempts to rewrite it.</p> <p>We believe the change report fails to demonstrate that the change proposal “...<i>facilitates the discharge by the DNO Party of the obligations imposed on it under the Act and by its Distribution Licence</i>”.</p> <p>Legal advice provided to the DCUSA panel by Gowling WLG advised that in the absence of AEC analysis, there is a risk that the DCP if implemented could result in an abusive margin squeeze. As far as we are aware, no such AEC analysis has been undertaken. In the absence of such analysis we struggle to understand how it is possible to claim that the DCP facilitates the discharge by relevant parties of obligations under the licence and the Act.</p> <p>Gowling WLG went on to say “<i>On the basis of the information reviewed to date, we are not aware of the extent to which the</i></p>	<ol style="list-style-type: none"> 1. The DCUSA change control process requires the proposer not merely to demonstrate that its proposal is equally as valid as the current approach but to show that it is definitively better. We do not believe they have done that. We recognise that there are issues with the current approach but there are clearly issues with the new approach and it’s not obvious that one is better than the other. We have not repeated in this voting form the significant and detailed concerns we raised in previous consultations but would recommend that these are read in parallel to this response. 2. The logic, rationale and analysis underpinning this change proposal is muddled, unclear and lacking in analysis. What analysis there is, is narrow and does not consider the broader impacts of the changes on IDNO margins. 3. Because we have been engaged with the SCR, we have been unable to provide the appropriate resource or scrutiny of the DCP and this change report as it has developed. We suspect the same may be true for other relevant DCUSA parties.
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			<p><i>CP could be shown to be objectively necessary or indispensable to achieving efficiency gains, which would give rise to consumer benefits outweighing any adverse effects of the CP</i>". The change report does not address these comments.</p> <p>Paragraph 3.5 of the change report makes reference to a "<i>perceived defect</i>". Despite challenges to the previous two consultations, the change report still fails to set out clearly what this defect is, and why it is a defect. Although paragraphs 3.6 to 3.17 of the change report claims to illustrate the defect, we think it falls significantly short in trying to do this.</p> <p>Paragraphs 3.6 and 3.12 produces two tables showing two sets of p/kWh "costs" but provides no coherent explanation to justify why the costs in the change proposal are a better reflection of the costs that an IDNO incurs.</p> <p>Paragraph 3.13 asserts that the change proposer "<i>...believes that the expected outcome does not materialise because of a flawed mathematical logic</i>", but is not clear on why the logic is flawed.</p> <p>Further, the DCP fails to demonstrate why the PCDM on its own produces a more reasonable determination of IDNO revenues than the current arrangements. We believe that using the PCDM on its own to determine IDNO revenues is flawed in a number of areas. For example:</p> <ul style="list-style-type: none"> • The PCDM uses a MEAV cost driver to allocate some costs (labelled as Opex) to network tiers; however: <ul style="list-style-type: none"> ➤ Some indirect costs are not allocated to network tiers by the PCDM. ➤ Some of the direct costs reported in DNO regulatory submissions do not relate directly to costs at each network tier (such costs having to be allocated by are proxies). ➤ Some network costs are fixed and not related to assets. For these, MEAV is an inappropriate mechanism for allocation. Examples of fixed type costs are those costs 	<p>4. We recognise there are a number of issues with both the CDCM and the PCDM and have previously provided inputs into the DNOs DCMF review of the CDCM. The output of that review was provided as an input into Ofgem's SCR reviews that are currently in progress. We have held back from raising change proposals, to address some of the concerns we have previously raised, on the basis that we believed that these are best addressed through the SCR on a holistic basis rather than on a piecemeal approach.</p> <p>5. Additionally, whilst DCUSA governance arrangements may be suited to small incremental changes to charging methodologies, we are concerned that they are largely ineffective at dealing with the administration of larger areas of change. DCP266 is a prime example of this having been initiated in March 2016.</p>
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			<p>that are not specific to the value of network assets; e.g. IT systems, call centres, customer administration, billing systems, etc.</p> <ul style="list-style-type: none"> ➤ Some of the costs incurred by IDNOs are not identified in the PCDM, in many cases they are a pass-through cost. Examples of such costs are: DCC charges and from industry code charges. <p><i>Note: Whilst DCP 306 dealt with the treatment of the allocation of licence fees, o date, we have held back from raising DCPs to address other aspects pending the conclusion of SCR.</i></p> <ul style="list-style-type: none"> • The capex cost driver is derived from DNO FBPQ submissions for DPR5 in respect of connections capex, general reinforcement, fault reinforcement, replacement capex and ESQCR cost submissions. Connections capex, general reinforcement and fault reinforcement, (all of which may make up a significant component of total capex are allocated to network tiers using repex as a cost driver). <p>We do not believe that the current change report demonstrates that the DCP delivers a methodology that better represents the margins of the equivalent notional downstream business that the DNO would require to operate the relevant networks and make a reasonable return.</p> <p>The “corrections” proposed in paragraph 3.18 only seek to underline the flaws in this approach. If the PCDM is to be used on its own, then a much more fundamental review of the input costs and the way they are allocated is required.</p> <p>Charging Objective 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)</p>	
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			<p>It is our view that neither the proposer nor the change report has demonstrated that the proposed change will better meet this objective; i.e. that it is better at not restricting, distorting or preventing competition in distribution.</p> <p>The impact assessment in paragraph 6.16 shows material reductions in IDNO margins in most cases. However, neither the working group, and to the best of our knowledge, none of the DNOs, have undertaken an AEC test to assess and analyse whether these margins result in abusive margin squeeze.</p> <p>We think that this is critical given the significant reductions in margins; for example, almost 20% in UKPN’s LPN DSA and 13% in UKPN’s EPN area.</p> <p>We have previously acknowledged that the PCDM is less than perfect, but that there is likely to be an element of “<i>swings and roundabouts</i>” where some aspects of the methodology have a positive effect on margins, whilst others have a negative effect. We believe that both the CDCM and the PCDM have flaws in this respect; however, this DCP does not address any of the identified flaws: it just seeks to impose a different methodology without providing appropriate economic justification.</p> <p>Charging Objective 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.</p> <p>We do not believe this objective is met.</p> <p>At a given voltage, DNO tariffs vary for different customer classes to reflect the different costs they bring to the distribution system.</p> <p>The implicit assumption in the DCP is that LDNOs bear essentially the same costs for all customer groups, such that</p>	
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			<p>there is no justification for LDNO revenues to differ in the same way as DNO revenues across different tariffs.</p> <p>There is nothing in the proposal by way of evidence to support this assumption. We believe such assumption is unfounded and as a result there is nothing in the proposal to show that the DCP better “...reflects the costs incurred, or reasonably expected to be incurred.”</p> <p>Also, the DCP if implemented, would not facilitate the development of locational charges (for generation or demand) – an option being considered under Ofgem’s SCR.</p> <p>Further, for this DCP to have merit, it needs to demonstrate that the way charges are allocated in the PCDM in isolation of the CDCM is more reflective than the current approach.</p> <p>Whilst the PCDM provides a mechanism to allocate costs to network tiers on a relative basis (in order to allocate CDCM revenues), the costs are not up to date.</p> <p>Although it is suggested that the CDCM is inappropriate mechanism because it is an incremental cost model, with the size of increment very large; i.e. 500MW.</p> <p>Therefore, the CDCM is more of an “allocative” model allocating costs to network tiers; rather than a LRIC approach dealing with a very small increase in demand on the existing network. Additionally, a significant proportion (for some DNOs) of unmodelled costs in the price control revenue (the residual component) are allocated through a scaler.</p> <p>Whilst we recognise there are imperfections in both the CDCM and PCDM, the proposer has not demonstrated that the proposed solution better reflects the revenues that a notional business of the DNO would need to operate an equivalent network and make a reasonable return.</p> <p>Charging Objective 4: That, so far as is consistent with Clauses 3.2.1 to 3.2.3, the Charging Methodologies, so far as is reasonably practicable, properly take account of developments in each DNO Party’s Distribution Business</p>	
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			<p>We think the DCP fails to satisfy this objective.</p> <p>Ofgem is undertaking two SCRs that are likely to impact significantly on DUoS charging methodologies going forward through:</p> <ul style="list-style-type: none"> a) changing the connection charging boundary; and, b) fundamentally reviewing the approach that DUoS charges are calculated (potentially moving to a different charging methodology and moving to locational charges). <p>We think at best, it was misguided to continue with this DCP in parallel with the SCRs. We are concerned that because of the SCR, the appropriate expertise and resource has not been available to commit to the development of this DCP (from both the DNO and IDNO communities). We therefore think the analysis and arguments for and against is incomplete.</p> <p>Charging Objective 5: That compliance by each DNO Party with the Charging Methodologies facilitates compliance with the Regulation on Cross-Border Exchange in Electricity and any relevant legally binding decisions of the European Commission and/or the Agency for the Co-operation of Energy Regulators.</p> <p>Not applicable.</p> <p>Charging Objective 6: that compliance with the Charging Methodologies promotes efficiency in its own implementation and administration.</p> <p>We believe the proposed changes result in a significant increase in the level of complexity in the methodologies and reduces the level of transparency to the extent that mere mortals have little chance of understanding or validating the methodology.</p> <p>We note that during this process in providing the assessment, DNOs themselves produced errors in their analysis (we also note, that DNOs have identified errors in IDNO charges).</p>	
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			Therefore, we do not believe that such an approach results in promoting efficiency in administration	
ESP Electricity	Reject	Reject	<p>DCP 266 is not consistent with DCUSA Charging Objectives 1, 2 or 3 and goes beyond code regulation. Its implementation could be a potential breach of Competition Law.</p> <p>The legal advice on this modification during its assessment clearly shows there is a significant risk of its implementation causing a margin squeeze for IDNOs thus breaching competition law. This is a non-trivial issue; there was also a risk of breaching internal competition law compliance policies that caused three parties to leave the working group.</p> <p>It follows that a change proposal with an anticompetitive impact will not support any Charging Objective.</p>	<p>It has not been demonstrated that there is a problem with the existing methodology in the first place.</p> <p>During the assessment there was no reference to any economic theory that offers an explanation as to the rationale for wealth transfers between parties.</p>
Last Mile Electricity Limited (formerly Energetics Electricity Limited)	Reject	Reject	<p>The Change Report notes that the majority of respondents believe that the DCUSA Charging Objectives are either negatively impacted by DCP 266 or that it has no impact – ie. it does not better facilitate those objectives (para 5.1). In the absence of “<i>better facilitation</i>” we consider it is not open to the Authority to approve the change.</p> <p>The following reasons have been given for suggesting that DCUSA Charging Objective 2 will be better facilitated”:</p> <ul style="list-style-type: none"> • “<i>by reducing or removing the current distortion in the absolute level of total avoided cost discount received by LDNOs</i>”. <p>We agree that removal of a distortion could better facilitate competition. But the nature of the alleged defect / distortion has still not been articulated since the issue was first raised in 2016, even following requests for further clarification in response to the First Consultation.</p> <p>The Second Consultation and the Change Report describe the operation of the current CDCM and the impact of DCP 266, but at no point has the proposer stated why it considers the current approach does not result in a reasonable allocation</p>	<p>The material risk of margin squeeze identified in the legal advice to the Working Group and the Panel has not been addressed – to the point where a number of participants felt obliged to leave the Working Group in order to comply with competition law.</p> <p>It is insufficient that DCP 266 (in the Proposer’s view) “<i>ensures an LDNO is able to receive the same margin as the host DNO’s notional downstream business</i>” – the question is whether that margin would allow – as a minimum - a reasonably efficient competitor to operate and make a reasonable profit within that margin <u>C-280/08 P, Deutsche Telekom v Commission [2010] ECR I-955.</u></p> <p>The legal advice received by both the Panel and the Working Group was that the margin squeeze risk cannot be discounted unless and until detailed economic analysis has been carried out</p>

			<p>of total cost - contrary to Ofgem’s and the DNOs’ original decision that it does (see below).</p> <p>It would be unreasonable for the Authority to conclude that DCUSA Charging Objective 2 is better facilitated by removal of a defect that: (a) has not been shown to exist; (b) if it does exist, has not been shown to have a distortionary effect on competition.</p> <ul style="list-style-type: none"> • <i>“by ensuring that the p/kWh discounts received by LDNOs remains aligned with the absolute level of avoided costs calculated in the PCDM, this change will promote competition in the distribution of electricity”.</i> <p>No reason was given as to why this change would promote competition per se; we therefore assume that this relates back to the removal of the alleged defect.</p> <p>Again, it would be unreasonable for the Authority to conclude that DCUSA Charging Objective 2 is better facilitated by removal of a defect that: (a) has not been shown to exist; (b) if it does exist, has not been shown to have a distortionary effect on competition.</p> <p>If this does not relate back to removal of the alleged defect, some explanation needs to be provided as to why this change, by itself, would promote competition.</p> <ul style="list-style-type: none"> • <i>“The Proposer believes the absolute level of discount (p/kWh) received by LDNOs [under DCP 266] is also likely to be more stable and predictable since it will be protected from the impact of any changes to the methodology for all-the-way CDCM tariffs, which will also promote competition in the distribution of electricity”.</i> <p>This suggests that the one benefit that does not rely on the existence of a defect is merely “likely”. We do not consider that a “likely” increase in stability and predictability is sufficient to justify the Proposer’s claim that DCP 266 will promote competition.</p>	<p>(Legal Advice, para 1.6 and 1.7). This analysis has not been carried out.</p> <p>It is therefore incorrect for the Change Report to suggest that sufficient analysis has been undertaken (para 2.2); however, if further analysis is required we consider it clear that it should be undertaken as part of the Access and Forward-Looking Charges SCR rather than as a discrete piece of work not properly integrated with the broader review of distribution charging.</p> <p>This is particularly the case given that the Authority has previously set the expectation that the existing “[cost] allocation methods [in the CDCM] are consistent with the view held by Ofgem that ... the charges should be based on a reasonable allocation of total costs to the elements of the DNOs business that are being undertaken by the IDNO” (Para 2.70, Electricity distribution structure of charges project: DNOs’ proposals for a common methodology at lower voltages – Ofgem, 28 September 2009).</p> <p>We consider that, in order to depart from this previous decision, the Authority must be in receipt of compelling evidence of a defect in the existing methodology, or that DCP 266 in some way improves upon the existing methodology. We do not consider this can be the case if DCP 266 carries with it an unaddressed and material risk of abusive margin squeeze.</p> <p>Indeed, approving a modification that carries an unaddressed and material risk of margin squeeze would be contrary to the Authority’s duties to ensure licensees can finance their activities (Electricity Act 1989, section 3A(2)(b)) and to promote competition wherever appropriate (section 3A(1B)), and we therefore question</p>
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				<p>whether the Authority would have <i>vires</i> to give such approval.</p> <p>We refer the Authority to our more detailed responses to the First Consultation and the Second Consultation, which are included in the change pack and should be taken as if set out here in full.</p>
Leep Utilities	Reject	Accept	We do not believe any DCUSA objectives are better facilitated by this change.	<p>The rationale behind the CP is unclear and have not been justified. The impacts of the CP have not been fully investigated.</p> <p>The SCRs being undertaken by Ofgem are likely to significantly impact DUoS and we consider that the CP should not have continued in light of the SCRs.</p> <p>The change report refers to a perceived defect but fails to substantiate where or amongst whom the perception has arisen, nor whether there is a defect.</p> <p>The reasoning & justification behind the original implementation of the existing arrangements was not considered.</p> <p>We consider that both the PDCM and the CDCM are flawed and this CP does not address any of those flaws.</p> <p>There is reference to a flawed mathematical logic in the current methodology, but the CP does not address the flaws in the PDCM.</p> <p>Even if it can be argued that the current methodology is flawed, the proposed change would merely move to another flawed methodology without justification.</p>

				<p>The legal advice sought by the working group stated that there was a risk that the CP could result in abusive margin squeeze.</p> <p>The legal advice recommended that “as efficient competitor” (“AEC”) tests be carried out in relation to the CP. No such tests have been carried out.</p> <p>The 45-month duration of this CP does raise concern in the ability of this change process to handle significant changes.</p>
Murphy Power Distribution	Reject	Reject	Tries to facilitate objective 3 but fails in delivery and scope	We believe that this is not cost reflective of DNO/IDNO allocations
Vattenfall Networks Limited	Reject	Reject	We do not believe that any of the DCUSA Objectives are better facilitated by the proposed changes.	<p>This change proposal was initiated in March 2016 which pre-dates the current Significant Charging Review (SCR) and Vattenfall’s decision to enter the iDNO market. In our view it is not appropriate for such a fundamental change proposal to be considered in parallel with the SCR. This leads to unnecessary uncertainty in understanding the impact of this change (if implemented) alongside the development and ultimately the outcome of the SCR.</p> <p>It is clear that significant concerns have been raised in previous consultations, including with respect to margin squeeze and competition law. We note that three Working Group members resigned from the Working Group due to such concerns and that in September 2019 it was decided to close down the Working Group.</p> <p>Vattenfall Networks does not support the implementation of</p>

SUPPLIER PARTIES

N/A				
CVA REGISTRANT PARTIES				
N/A				
GAS SUPPLIER PARTIES				
N/A				