

Proposed variation:	Distribution Connection and Use of System Agreement (DCUSA) DCP361: Ofgem Targeted Charging Review (TCR) Implementation – Calculation of Charges		
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:	30 September 2020	Implementation date:	1 April 2022

Background

In November 2019, we published our Decision (and associated Direction) on the Targeted Charging Review (TCR) Significant Code Review.⁴ Once the Decision is implemented, the costs of operating, maintaining and upgrading the electricity grid will be spread more fairly and, through reducing harmful distortions, will save consumers approximately £300m per year, with anticipated £4bn-£5bn consumer savings in total over the period to 2040.

The TCR included a review of how residual network charges are set and recovered. The aim of the TCR is to ensure that these charges are recovered from network users in a way that meets the TCR Principles:

- reducing harmful distortions,
- fairness, and
- proportionality and practical considerations.

We decided that residual charges should apply to final demand consumers only and that they will be fixed charges, with implementation of these changes in 2022. For distribution residual charges, we decided that domestic consumers should pay a single residual charge set for each licensed distribution area, and non-domestic consumers should be charged on the basis of a set of fixed charging bands, also set for each licensed distribution area. In our decision, we included provisions to review and revise (as appropriate) these charging bands and their boundaries so that the outcome of such reviews can be implemented alongside the commencement of each new electricity transmission price control. The fixed charging bands will be published at a national level and shall be set for each licensed distribution area.

Alongside our decision, we issued a Direction⁵ to the Distribution Network Operators (DNOs), to bring forward proposals to modify the Distribution Connection and Use of System Agreement (DCUSA) in relation to residual charges, to give effect to the terms of the TCR Direction.

DNOs recover their allowed revenue from their customers through distribution use of system (DUoS) tariffs. Currently, the residual component of the DUoS tariffs is added once forward-looking charges have been applied, to recover the remaining allowed revenue for network companies set under the price controls.

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 https://www.ofgem.gov.uk/system/files/docs/2019/12/full_decision_doc_updated.pdf

⁵ https://www.ofgem.gov.uk/system/files/docs/2019/11/dcusa_direction_1.pdf

The modification proposal

Four DCUSA modification proposals were raised to implement the distribution residual charging reforms resulting from the TCR Decision. SP Energy Networks (the 'Proposer') raised modification DCP361 (the 'Proposal') on 14 January 2020.⁶ A Working Group was set up to consider the proposed modification.

DCP361 would update the methodologies to calculate residual charges for final demand customers in different bands as specified in the TCR Direction. It would do so based on proposals developed under the associated DCUSA TCR proposed modifications: the definitions developed under DCP359, and the processes developed under DCPs 358 and 360.⁷

The proposal would calculate a single residual charge for domestic consumers and a set of banded residual charges for other consumers, with equal residual charges for each consumer in a given band. Charges would be levied on a pence per site per day basis, except for unmetered supplies which would be charged on a pence per kilowatt hour basis.

The proposer of DCP361 believes that the modification would better facilitate two of the DCUSA Charging Objectives:⁸

- The first DCUSA Charging Objective, by ensuring DNOs are compliant with licence requirements in relation to Significant Code Reviews (SCRs), by implementing specific requirements set out in the TCR Direction.
- The second DCUSA Charging Objective, by ensuring network costs are recovered fairly from network users and to reduce harmful distortions which impact competition and efficiency of the electricity market.

DCUSA Parties' recommendation

In each party category where votes were cast,⁹ there was unanimous support for the Proposal. For the majority of party categories where votes were cast, there was majority (>50%) support for its proposed implementation date. In accordance with the weighted vote procedure, the recommendation to the Authority is that DCP361 is accepted. The outcome of the weighted votes is set out in the tables below:

DCP361	WEIGHTED VOTING (%)									
	DNO		IDNO ¹⁰		SUPPLIER		CVA REGISTRANT		GAS SUPPLIER	
	Accept	Reject	Accept	Reject	Accept	Reject	Accept	Reject	Accept	Reject
CHANGE SOLUTION	100	0	100	0	100	0	None	None	N/A	N/A
IMPLEMENTATION DATE	74	26	80	20	50	50	None	None	N/A	N/A

⁶ <https://www.dcusa.co.uk/change/ofgem-targeted-charging-review-implementation-calculation-of-charges/>

⁷ DCP358: Determination of Banding Boundaries, DCP359: Customers: Who Should Pay? and DCP360: Allocation to Bands.

⁸ The DCUSA Charging Objectives (Relevant Objectives) are set out in Standard Licence Condition 22A Part B of the Electricity Distribution Licence.

⁹ There are currently no gas supplier parties.

¹⁰ Independent Distribution Network Operator

Our decision

We have considered the issues raised by the proposal and the Change Declaration and Change Report issued on 12 August 2020. We have also considered and taken into account the responses to the consultation that the Working Group issued and the votes of the DCUSA Parties on the Proposal, which are attached to the Change Declaration. We have concluded that:

- implementation of the Proposal will better facilitate the achievement of the DCUSA Charging Objectives; and
- directing that the modification be made is consistent with our Principal Objective and statutory duties.¹¹

Reasons for our decision

We consider the Proposal will better facilitate the first, second and third Applicable DCUSA Charging Objectives and has a neutral impact on the other relevant objectives.

First Applicable Charging Methodology Objective – that compliance with the Relevant Charging Methodology facilitates the discharge by a Distribution Services Provider¹² of the obligations imposed on it under the Act and by its licence

The Working Group unanimously agreed with the Proposer that DCP361 would better facilitate the first DCUSA Charging Objective. All DCUSA voting parties also agreed with this view as did many respondents to the consultation. They highlighted that the proposal would ensure DNOs are compliant with their licence requirements in relation to the SCR, by implementing the specific requirements set out in the TCR Direction. One consultation respondent stated it does not agree with the TCR Decision but acknowledged that the modification meets its intention.

Our Position

We directed the DNOs to implement the TCR Decision by proposing a means of calculating the residual charges for final demand consumers. We agree that DCP361 better facilitates this objective, as the Working Group has brought forward a proposed solution that meets the TCR Direction and the intent of the TCR Decision.

There were certain areas of the TCR Direction where the Working Group had some discretion in proposing an appropriate solution. For all of these areas, we consider that the Proposal meets the TCR Direction. These areas included how to deal with negative residual charges and the reallocation of customers for bands with low numbers.

The Proposal would ensure that consumers cannot receive a negative fixed charge, i.e. be paid for simply being connected to the network. This is consistent with the principles of the TCR. Any remaining negative residual would be returned via unit charge adders across unit charges within the relevant charging band.

¹¹ 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.

¹² Distribution Services Provider: 'means any Electricity Distributor in whose Electricity Distribution Licence the requirements of Section B of the standard conditions of that licence have effect (whether in whole or in part).'

In our Direction, we required DNOs to assess approaches to banding should there be very low consumer numbers in some bands. The Proposal includes a prescribed approach to merging bands to ensure a minimum of two consumers in each charging band. This approach, of a minimum of two consumers per band, is consistent with that used in our impact assessment for the TCR Direction and was one of the options highlighted in the TCR Direction. We agree that this approach represents a sufficient minimum threshold in any charging band to protect the identity of those sites.

Second Applicable Charging Methodology Objective – that compliance with the Relevant Charging Methodology 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 the participation in the operation of an Interconnector

The Working Group unanimously agreed with the Proposer that DCP361 would better facilitate the second DCUSA Charging Objective. The majority of DCUSA voting parties also agreed with this view as did many respondents to the consultation. They considered this objective would be better facilitated by ensuring network costs are recovered fairly from network users and to reduce harmful distortions which impact competition and efficiency of the electricity market. No parties raised concerns with respect to this objective.

Our Position

We consider that DCP361 better facilitates this objective. We think that current charging arrangements for the recovery of residual charges are distortive and lead to network costs being disproportionately recovered from certain network users. We consider that residual charges should be paid by final demand consumers to reduce the potential for distortion and improve competition between different types of generators.

Third Applicable Charging Methodology Objective – that compliance with the Relevant Charging Methodology results in charges that, so far as is reasonably practicable after taking account of implementation costs, reflect the costs incurred, or reasonably expected to be incurred, by a Distribution Services Provider in its Distribution Business

No comments were made with respect to the third DCUSA Charging Objective by the Proposer, Working Group or DCUSA voting parties, all of whom considered DCP361 neutral against this objective.

Our position

We consider DCP361 better facilitates the third DCUSA Charging Objective. As stated in the TCR Decision, we consider that distortions to the effects of cost-reflective signals can be reduced by placing residual charges onto final demand users only. DCP361 gives effect to our decision to calculate residual charges to apply only to final demand, removing this distortion and therefore improving the cost-reflectivity of charges faced by users.

Implementation of DCP361

The proposed implementation date of DCP361 is 1 April 2022. Two voting parties and several consultation respondents commented on the implementation date, with the weighted voting of the supplier parties against the proposed implementation date. The comments focused on the impact of Covid-19 and concerns covered the additional disruption to charges at an uncertain time, and the effects on patterns of consumption to the data being used to calculate the charging bands.

These views relate to the implementation of the TCR Direction in general rather than DCP361 in particular, which calculates distribution residual charges. We consider these implementation issues in more detail in our assessment of DCPs 358 and 360, which we have published alongside this decision.

Another consultation respondent considered that the definition of a residual charge is still under review (under our Access and forward-looking charges SCR) and implementation should be delayed until that term has been defined.¹³ While that SCR could change the scale for recovery of forward-looking charges, which may result in a consequential impact on the value of the residual charge, we do not agree that the definition of a residual charge is still under review.¹⁴

One consultation respondent considered that there are a number of interacting reforms, including the Ofgem Switching Programme, that may make implementation in 2022 more challenging. We are aware of these interactions and believe that they can be adequately managed by industry to enable implementation by 2022. We will continue to monitor these projects and take steps to support industry coordination where appropriate.

There are equivalent Connection and Use of System Code (CUSC) modification proposals for transmission network residual charging. Having considered the final proposed legal text for the equivalent CUSC proposals we are able to issue our decision on this DCUSA proposal. Please note that nothing in this decision in any way fetters our discretion with respect to our decision on those CUSC modification proposals.

Impact Assessment

Section 5A of the Utilities Act 2000 imposes a duty on the Authority (its 'Section 5A duty') to undertake an impact assessment in certain circumstances. In particular, that applies where it appears to the Authority that a proposal is important. A proposal is important for these purposes if its implementation would be likely to, among other things, "have a significant impact on persons engaged in commercial activities connected with the ... generation, transmission, distribution or supply of electricity." Where this applies, the Authority is obliged to carry out an impact assessment.

We conducted an impact assessment as part of our TCR Significant Code Review which was taken into consideration in our final Decision. The methodology for the calculation of residual charges for final demand consumers, as achieved by DCP361, is consistent with our TCR Decision. DCP361 will give effect to specific aspects of the Decision, and as such, we consider that the impact assessment conducted for the TCR Decision satisfied our

¹³ <https://www.ofgem.gov.uk/electricity/transmission-networks/charging/reform-network-access-and-forward-looking-charges>

¹⁴ We considered potential changes to the size of the residual and undertook sensitivity analysis of this in the impact assessment that supported our TCR Decision.

obligations under the Utilities Act, with respect to this modification. In addition, the DCUSA modelling consultants produced an impact assessment for DCP361 to present potential impacts of the Proposal on typical bills for different customer types.

One consultation respondent commented on the results of the DCP361 impact assessment. It considered there would be a 'significant increase in costs to consumers in Northern Scotland and London'. The DCP361 impact assessment suggests a 4.6% increase in the residual charge for domestic consumers in Northern Scotland. This is within the range of modelled outcomes for consumption levels of domestic consumers in the impact assessment for our TCR Decision. This static distributional impact does not include the long-term savings for consumers from the full package of reforms, estimated at £4bn-£5bn in total over the period to 2040.

For London, the DCP361 impact assessment shows significant increases (up to 50%) only for 'Related MPANs'. This is because the TCR reforms ensure residual charges are levied per site. The highlighted impact is a result of those consumers no longer receiving the negative residual more than once for the same site. This is in line with the intention of our TCR Decision. For areas with a positive residual, sites with more than one meter would see a reduction in residual charges.

Decision notice

In accordance with standard licence condition 22.14 of the Electricity Distribution Licence, the Authority hereby directs that modification proposals *DCP361: Ofgem Targeted Charging Review (TCR) Implementation – Calculation of Charges* be made.

Andrew Self
Deputy Director, Electricity Access and Charging – Energy Systems Management & Security

Signed on behalf of the Authority and authorised for that purpose