Modification proposal:	**Distribution Connection and Use of System Agreement (DCUSA) Change Proposal (CP) 395 – Allocation of Smart Meter Communication Licence costs within LDNO Tariffs**		
Decision:	The Authority[1] directs that this modification be made[2]		
Target audience:	DCUSA Panel, Parties to the DCUSA and other interested parties		
Date of publication:	21 July 2022	Implementation date:	01 April 2024

Background

The Price Control Disaggregation Model (PCDM) is used to calculate the discounts applied to charges to determine tariffs for Distribution Network Operators (DNOs). However, Smart Meter Communication Licence Fees (Data Communications Company charges) are not considered in the costs which are used to determine cost drivers within the PCDM as the cost data is taken from when Smart Meter Communication Licence Fees did not exist. The current PCDM methodology requires all distributors to pay these fees on an equal basis therefore distributing the fees across all network tiers. As a result, Licenced Distribution Network Operators (LDNOs) tariffs are not reflective of the costs incurred by an LDNO.

DCP395 seeks to change the allocation of the Smart Meter Communication Licence Fee to allow LDNOs to recover all of the fees as they are incurred by the Distribution System providing the last mile of the network, rather than distributing such allocation across all network tiers through the use of cost drivers which do not consider the Smart Meter Communication Licence Fees in their derivation.

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

The modification proposal

DCP395 was raised by The Electricity Network Company (the "Proposer") on 5 October 2021. The intent of the modification is to make changes which ensure that LDNO tariffs better reflect the costs that are avoided by the DNOs when customers are connected to their network via an LDNO and that such fully avoided costs are allocated to the downstream LDNO. The Proposer believes that the Change Proposal (CP) would better facilitate DCUSA Charging Objectives 2[3] and 3[4].

Smart Meter Communication Licence Fees are calculated and charged to DNOs at present, on a "£ per Meter Point Administrator Number (MPAN)" basis in accordance with Section K of the Smart Energy Code (SEC). The recovery of these Fees is not presently allocated by either the Common Distribution Charging Methodology (CDCM) or PCDM as a specific cost item. In the CDCM, the revenue to be recovered in respect of such charges is included as part of the target revenue to be recovered by the CDCM. Therefore, DNOs recover the total costs associated with DCC Charges in respect of customers connected directly to their network.

However, for determining charges applied to LDNOs, the PCDM does not identify Data Communications Company (DCC) Charges as a separate cost item which means they are not considered in the calculation of the operational expenses (Opex) cost driver. This means that in calculating charges to downstream LDNOs, only a proportion of the revenue required to cover the DCC Charges is allocated – even though the DNO avoids it entirely. This discount factor calculated by the PCDM should enable the downstream LDNO to recover the costs associated with DCC Charges in full.

The current cost allocation driver does not take into account the Smart Meter Communication Licence Fee which means that the costs are distributed across all network levels which makes the resultant LDNO tariffs unreflective of the costs incurred by a LDNO. This occurs as the cost data for the PCDM is taken from a period of time when

[3] 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).
[4] 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.

Smart Meter Communication Licence Fees did not exist. Yet these fees are payable by all distributors on an equal basis.

The proposal puts forward two options for consideration by the Panel and Working Group:

- The proposed solution in Option one would add the costs of the Smart Meter Communication Licence Fee into the calculation of the allocation driver applied to operating costs within DCUSA Schedule 29. This would mean that the total costs would be directly allocated to the Low Voltage (LV) service network tier as it is the volume of customers that directly drives the level of costs. The inclusion of the Fee would be in addition to the costs already considered in the determination of the cost driver.
- Option two sought to include the Smart Meter Communication Licence Fee in the additional revenue to be shared under paragraph 23 of DCUSA Schedule 29. This option would also require the revenue to be directly allocated to the LV service network tier (or a separate driver to be established based on customer numbers).

Option one was agreed by the Panel and Working Group as the most appropriate method of improving cost allocation of the Smart Meter Communication Licence Fee. As a feature of option one, the Fee will be converted from nominal prices to 2007/08 prices in line with the rest of the costs within the PCDM. In summary, the proposal will include the Smart Communication Licence Fee when calculating the allocation driver for operating expenses and directly allocate 100% of it to the LV Service.

The full legal text is included within the Change Report.

DCUSA Parties' recommendation

In each party category where votes were cast (no votes were cast in the supplier, CVA Registrant party or Gas Supplier categories),[5] there was majority (>50%) support for the proposal and for its proposed implementation date. In accordance with the weighted vote procedure, the recommendation to the Authority is that DCP395 is accepted. The outcome of the weighted vote is set out in the table below:

[5] There are currently no gas supplier parties.

DCP 395	WEIGHTED VOTING (%)									
	DNO		IDNO		Supplier		CVA Registrant[6]		Gas Supplier[7]	
	Accept	Reject	Accept	Reject	Accept	Reject	Accept	Reject	Accept	Reject
Change Solution	55%	45%	100%	0%	n/a	n/a	n/a	n/a	n/a	n/a
Implementation Date	55%	45%	100%	0%	n/a	n/a	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 11 May 2022. 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 Applicable DCUSA Charging Objectives 2 and 3[8]; and

- directing that the modification be approved is consistent with our principal objective and statutory duties.[9]

Reasons for our decision

We consider this modification proposal will better facilitate DCUSA Charging Objectives 2 and 3 and has a neutral impact on the other applicable objectives.

Applicable DCUSA Charging Objective (2) – that compliance by each DNO Party with Charging Methodologies facilitates competition in the generation and supply of electricity and will not restrict, distort, or prevent competition in the

[6] This Party Category was not eligible to vote on this CP.
[7] This Party Category was not eligible to vote on this CP.
[8] The Applicable DCUSA Charging Objectives are set out in Standard Licence Condition 22.2 of the Electricity Distribution Licence.
[9] 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.

transmission or distribution of electricity or in participation in the operation of an Interconnector (as defined in the Distribution Licences)

Concerns were raised by DNOs during the consultation that the principle of the change should not look at the PCDM in isolation and Fees would be better obtained by utilising the CDCM. We agree with the Working Group and Panel's response to these concerns that if this is placed in the CDCM, it would affect the 'all-the-way tariffs', which is outside of the intent of this change. Additionally, the Working Group advised that this – CDCM - methodology would require additional modelling which may delay implementation of the change by 12 months which we have taken into our consideration.

We have also considered the suggestion that the most cost reflective allocation would be at voltage level. However, we agree with the Working Group and Panel that, based on the evidence that there is 99.1% of customers connected at the LV network level, that the Smart Meter Communication Licence Fee should be applied to the LV.

We agree with the Panel that this proposal better facilitates DCUSA Charging Objective 2 as the current omission of the Smart Meter Communication Licence Fee in determining LDNO tariffs could have the impact of distorting competition in the distribution of electricity by not allowing LDNOs to properly recover costs which they have properly and efficiently incurred. The current methodology was created at a time when the Smart Meter Communication Licence Fee did not exist, therefore the PCDM in its current form does not proportionally reflect LDNO costs and should be updated in order to accurately reflect the impact of the Smart Meter Communication Licence Fee on LDNOs.

This provides a more accurate allocation of the Smart Meter Communication Licence Fee costs and how these are treated within the PCDM, better reflecting costs incurred by LDNOs, thereby better facilitating this Objective.

Applicable DCUSA Charging Objective (3)– that compliance by each DNO Party with the Charging Methodologies, so far 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

We believe that DCP395 will have a positive impact on DCUSA Charging Objective 3 as it will address the discrepancy of Smart Meter Communication Licence Fee recovery between the LDNOs and DNOs and, once implemented, will contribute towards a more cost reflective charging model for the LDNOs. This will in turn increase cost reflectivity specific to the recovery of the Smart Meter Communication Licence Fee.

The proposal better accounts for the introduction of Smart Meter Communication Licence Fee costs as it more accurately reflects the development of the Fee being introduced and the cost being applied appropriately in the PCDM model.

This Objective is better facilitated by the proposal as the charges associated with the Smart Meter Communication Licence will be directly allocated to the LV Service Network Tier within the PCDM in an efficient way and it has been confirmed that 99.91% of the DNO's customers are connected to the LV network. This modification would therefore better facilitate this Objective.

Decision notice

In accordance with standard licence condition 22.14 of the Electricity Distribution Licence, the Authority hereby directs that modification proposal DCP395: 'Allocation of Smart Meter Communication Licence costs within LDNO tariffs' be made.

Michael Walls
Head of Retail Market Operations
Signed on behalf of the Authority and authorised for that purpose