









DCUSA Change Proposal (DCP)		At what stage is this document in the process?
<h1>DCP 438:</h1> <h2>Rate of Return Change Proposal</h2> <p>Date Raised: 27/02/2024</p> <p>Proposer Name: Babatunde Olukotun</p> <p>Company Name: National Grid Electricity Distribution</p> <p>Party Category: DNO</p>		01 – Change Proposal
		02 – Consultation
		03 – Change Report
		04 – Change Declaration
<p>Purpose of Change Proposal:</p> <p>This change proposal aims to update the rate of return as the previous legal text is out of date.</p>		
	<p>Governance:</p> <p>The Proposer recommends that this Change Proposal should be:</p> <ul style="list-style-type: none"> • Treated as a Part 1 Matter • Treated as a Standard Change • Progressed to the Working Group phase <p>The Panel will consider the proposer's recommendation and determine the appropriate route.</p>	
	<p>Impacted Parties:</p> <p>Suppliers/ DNOs/ IDNOs</p>	
	<p>Impacted Clauses:</p> <p>Schedules 16,17,18</p>	

Contents		 Any questions?
1	Summary	3
2	Governance	3
3	Why Change?	4
4	Solution and Legal Text	4
5	Code Specific Matters	5
6	Relevant Objectives	5
7	Impacts & Other Considerations	6
8	Implementation	7
9	Recommendations	7
Indicative Timeline		 DCUSA@electralink.co.uk
The Secretariat recommends the following timetable:		 020 7432 3011
Initial Assessment Report	20 March 2024	Proposer:
Consultation Issued to Industry Participants	May 2024	Babatunde Olukotun
Change Report Approved by Panel	21 August 2024	 email address bolukotun@nationalgrid.co.uk
Change Report issued for Voting	22 August 2024	 telephone 01179332299
Party Voting Closes	12 September 2024	
Change Declaration Issued to Parties	16 September 2024	
Change Declaration Issued to Authority	16 September 2024	
Authority Decision	TBC	

1 Summary

What?

1.1 This change proposal aims to update the rate of return as the previous legal text is out of date.

Why?

1.2 According to the current industry legal text:

“Annuity rate of return *Set to equal the latest pre-tax real weighted average cost of capital (CC below) for each DNO Party calculated using the following formula:*

$$CC = (\text{Gearing Assumption} \times \text{Pre-Tax Cost of Debt}) + (1 - \text{Gearing Assumption}) \times (\text{Post Tax Cost of Equity} / (1 - \text{Corporation Tax Rate}))$$

where:
Gearing Assumption is set to the ‘notional Gearing’ value referred to in the ED1 Price Control Financial Handbook;
Pre-Tax Cost of Debt is set to the ‘cost of corporate debt’ value specified in or calculated in accordance with the most recent Annual Iteration Process applicable when setting distribution Use of System Charges;
Post Tax Cost of Equity is set to the ‘cost of equity’ value referred to in the ED1 Price Control Financial Handbook; and
Corporation Tax Rate is the rate of corporation tax which is, when setting distribution Use of System Charges, expected to be applicable in respect of the regulatory year (as defined in the Distribution Licence) in which those Charges will take effect.
The CC value is calculated as a percentage, and rounded to two decimal places. ”

1.3 There is a need to update the above legal text so that it does not refer to ED1 price control period because it is no longer relevant.

How?

1.4 The parts that we will need to change are the Gearing assumption, the pre-tax cost of debt and the post-tax cost of equity as these refer to previous price control period. The suggestion is to remove reference to previous price control period.

1.5 The cells in the PCFM that these could refer to are:

- Gearing assumption – ‘Notional gearing’ taken from worksheet “InputSummary” row 180;
- Pre-tax cost of debt – ‘Allowed return on debt’ taken from worksheet “InputSummary” row 158;
- Post-tax cost of equity – ‘Allowed return on equity’ taken from worksheet “InputSummary” row 173;
- Corporation tax – ‘Corporation tax rate’ taken from worksheet “InputSummary” row 264.

1.6 We suggest the wording does not refer to the rows just the names as the format of the PCFM may change.

2 Governance

Justification for Part 1 and Part 2 Matter

2.1 This is a part 1 matter as it affects prices

Requested Next Steps

2.2 This Change Proposal should:

- Be treated as a Part 1 Matter;
- Be treated as a Standard Change; and
- Proceed to the Working Group phase.

2.3 This change can be applied for the prices set for 1st April, 2026.

3 Why Change?

3.1 According to the current industry legal text:

“Annuity rate of return *Set to equal the latest pre-tax real weighted average cost of capital (CC below) for each DNO Party calculated using the following formula:*

$$CC = (\text{Gearing Assumption} \times \text{Pre-Tax Cost of Debt}) + (1 - \text{Gearing Assumption}) \times (\text{Post Tax Cost of Equity} / (1 - \text{Corporation Tax Rate}))$$

where:
Gearing Assumption is set to the ‘notional Gearing’ value referred to in the ED1 Price Control Financial Handbook;
Pre-Tax Cost of Debt is set to the ‘cost of corporate debt’ value specified in or calculated in accordance with the most recent Annual Iteration Process applicable when setting distribution Use of System Charges;
Post Tax Cost of Equity is set to the ‘cost of equity’ value referred to in the ED1 Price Control Financial Handbook; and
Corporation Tax Rate is the rate of corporation tax which is, when setting distribution Use of System Charges, expected to be applicable in respect of the regulatory year (as defined in the Distribution Licence) in which those Charges will take effect.
The CC value is calculated as a percentage, and rounded to two decimal places. ”

3.2 There is need to update the above legal text so that it does not refer to ED1 price control period because it is no longer relevant.

4 Solution and Legal Text

Legal Text

4.1 Replace Annuity rate of return definition in schedule 16 paragraph 57, schedule 17 paragraph 2.16, and schedule 18 paragraph 2.9.

“Annuity rate of return

Set to equal the latest pre-tax real weighted average cost of capital (CC below) for each DNO Party calculated using the following formula:

$CC = (\text{Gearing Assumption} \times \text{Pre-Tax Cost of Debt}) + (1 - \text{Gearing Assumption}) \times (\text{Post Tax Cost of Equity} / (1 - \text{Corporation Tax Rate}))$

where:

Gearing Assumption is set to the ‘Notional gearing’ value for the regulatory year for which tariffs are being set in the latest version of the PCFM prepared for the relevant DNO Party for publication with such tariff setting on the DNO Party’s website;

Pre-Tax Cost of Debt is set to the “Allowed return on debt” value for the regulatory year for which tariffs are being set in the latest version of the PCFM prepared for the relevant DNO Party for publication with such tariff setting on the DNO Party’s website;

Post Tax Cost of Equity is set to equal the “Allowed return on equity” value for the regulatory year for which tariffs are being set in the latest version of the PCFM prepared for the relevant DNO Party for publication with such tariff setting on the DNO Party’s website; and

Corporation Tax Rate is set to equal the “Corporation tax rate” value for the regulatory year for which tariffs are being set in the latest version of the PCFM prepared for the relevant DNO Party for publication with such tariff setting on the DNO Party’s website.

The CC value is calculated as a percentage, and rounded to two decimal places. ”

5 Code Specific Matters

5.1 N/A

6 Relevant Objectives

	DCUSA General Objectives	Identified impact
<input checked="" type="checkbox"/>	1. The development, maintenance and operation by the DNO Parties and IDNO Parties of efficient, co-ordinated, and economical Distribution Networks	Positive
<input checked="" type="checkbox"/>	2. The facilitation of effective competition in the generation and supply of electricity and (so far as is consistent therewith) the promotion of such competition in the sale, distribution and purchase of electricity	Positive
<input checked="" type="checkbox"/>	3. The efficient discharge by the DNO Parties and IDNO Parties of obligations imposed upon them in their Distribution Licences	Positive
<input type="checkbox"/>	4. The promotion of efficiency in the implementation and administration of the DCUSA	None
<input type="checkbox"/>	5. Compliance with the EU Internal Market Regulation and any relevant legally binding decisions of the European Commission and/or the Agency for the Co-operation of Energy Regulators.	None

	DCUSA Charging Objectives	Identified impact
<input checked="" type="checkbox"/>	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	Positive
<input checked="" type="checkbox"/>	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)	Positive
<input checked="" type="checkbox"/>	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	Positive
<input checked="" type="checkbox"/>	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	Positive
<input type="checkbox"/>	5. That compliance by each DNO Party with the Charging Methodologies facilitates compliance with the EU Internal Market Regulation and any relevant legally binding decisions of the European Commission and/or the Agency for the Co-operation of Energy Regulators; and	None
<input checked="" type="checkbox"/>	6. That compliance with the Charging Methodologies promotes efficiency in its own implementation and administration.	Positive

6.1 There is a need for this CP so that DCUSA does not refer to ED1 price control period because it is no longer relevant.

7 Impacts & Other Considerations

7.1 No other impacts.

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

7.2 No.

Does this Change Proposal Impact Other Codes?

BSC..... ☐ MRA..... ☐

CUSC..... ☐ SEC..... ☐

Grid Code..... ☐ REC..... ☐

Distribution Code.. ☐ None..... ☒

Consideration of Wider Industry Impacts

7.3 N/A

Confidentiality

7.4 No

8 Implementation

Proposed Implementation Date

8.1 Next issue of DCUSA following approval.

9 Recommendations

The Code Administrator will provide a summary of any recommendations/determinations provided by the Panel in considering the initial Change Proposal. This will form part of a Final Change Report.