

DCP 438: Rate of Return

Legal Drafting

Amend the definitions in Clause 1 (Definitions and Interpretation) as follows:

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| ED1 Price Control Financial Handbook | has the meaning given to that term in the charge restriction conditions in the Distribution Licences. |
| <u>Price Control Financial Model or PCFM</u> | <u>has the meaning given to that term in the charge restriction conditions in the Distribution Licences.</u> |

Amend Table 3 in Paragraph 57 of Schedule 16 (CDCM) as follows:

Annuitisation of network model asset values

57. Capital costs that are not covered by customer contributions are converted to annual costs using a level annuity with the annuity period and rate of return set out in table 3.

| Table 3: Annuity rate of return and annuity period | |
|---|---|
| Parameter | Value |
| Annuity period | 40 |
| Annuity rate of return | <p>Set to equal the latest pre-tax real weighted average cost of capital (CC below) for each DNO Party calculated using the following formula:</p> $CC = (\text{Gearing Assumption} \times \text{Pre-Tax Cost of Debt}) + (1 - \text{Gearing Assumption}) \times (\text{Post Tax Cost of Equity} / (1 - \text{Corporation Tax Rate}))$ <p>where:</p> <p>Gearing Assumption is set to the 'Notional <u>gGearing</u>' value <u>for the regulatory year for which tariffs are being set in the latest version of the PCFM (InputSummary sheet, Finance inputs, Vanilla allowed return on capital) prepared for the relevant DNO Party for publication with such tariff setting on the DNO Party's website referred to in the ED1 Price Control Financial Handbook;</u></p> <p>Pre-Tax Cost of Debt is set to the '<u>Allowed return on cost of corporate debt</u>' value <u>for the regulatory year for which tariffs are being set in the latest version of the PCFM (InputSummary sheet, Finance inputs, CAPM calculator tool: allowed return on debt) prepared for the relevant DNO Party for publication with such tariff setting on the DNO Party's website specified in or calculated in accordance with the most recent Annual Iteration Process applicable when setting distribution Use of System Charges;</u></p> <p>Post Tax Cost of Equity is set to the '<u>Allowed return on cost of equity</u>' value <u>for the regulatory year for which tariffs are being set in the latest version of the PCFM (InputSummary sheet, Finance inputs, CAPM calculator tool: allowed return on equity) prepared for the relevant DNO Party for publication with such tariff</u></p> |

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| | <p>setting on the DNO Party’s website referred to in the ED1 Price Control Financial Handbook; and</p> <p>Corporation Tax Rate is <u>set to the rate of ‘Corporation tax rate’ value for the regulatory year for which tariffs are being set in the latest version of the PCFM (InputSummary sheet, Tax, Tax policy) prepared for the relevant DNO Party for publication with such tariff setting on the DNO Party’s website</u>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.</p> <p><u>In the event of any value not being available from the above data sources, the DNO Party will prepare a forecast of the value to be used in the CC formula instead.</u></p> <p>The CC value is calculated as a percentage, and rounded to two decimal places.</p> |
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Amend Paragraph 2.16 of Schedule 17 (EDCM) as follows:

2.16 The FCP load incremental charging function is in integral form with exponential load growth and continuous discounting applied. The following charging function is used to derive the Network Group FCP load incremental charge (£/kVA/annum) for EDCM Customers:

$$FCP_{load} = \sum_j \frac{i \left(\frac{A_j}{C_l}\right) \left(\frac{D}{C_l}\right)^{\frac{2i}{g_l}-1}}{1 - e^{-ir}}$$

Where:

FCP_{load} = FCP load incremental charge (£/kVA/annum)

j = in index of Branch whose reinforcement is required in the planning period

i = discount rate, which is 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 ‘~~n~~Notional gGearing’ value for the regulatory year for which tariffs are being set in the latest version of the PCFM (InputSummary sheet, Finance inputs, Vanilla allowed return on capital) prepared for the relevant DNO Party for publication with such tariff setting on the DNO Party’s website~~referred to in the ED1 Price Control Financial Handbook~~;

Pre-Tax Cost of Debt is set to the ‘~~Allowed return on cost of corporate~~ debt’ value for the regulatory year for which tariffs are being set in the latest version of the PCFM (InputSummary sheet, Finance inputs, CAPM calculator tool: allowed return on debt) prepared for the relevant DNO Party for publication with such tariff setting on the DNO

~~Party's websites 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 'Allowed return on cost of equity' value for the regulatory year for which tariffs are being set in the latest version of the PCFM (InputSummary sheet, Finance inputs, CAPM calculator tool: allowed return on equity) prepared for the relevant DNO Party for publication with such tariff setting on the DNO Party's website referred to in the ED1 Price Control Financial Handbook; and

Corporation Tax Rate is ~~set to the rate of 'Corporation tax rate' value for the regulatory year for which tariffs are being set in the latest version of the PCFM (InputSummary sheet, Tax, Tax policy) prepared for the relevant DNO Party for publication with such tariff setting on the DNO Party's website which is, when setting distribution Use of System Charges, expected to be applicable in respect of the Regulatory Year in which those Charges will take effect.~~

In the event of any value not being available from the above data sources, the DNO Party will prepare a forecast of the value to be used in the CC formula instead.

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

- $A_j =$ total cost (£) of asset "j" reinforcement in the considered Network Group over 10-year period
- $l =$ index of the total load level at which reinforcement of Branch "j" is required
- $Cl =$ total demand (kVA) of the Network Group, in the Maximum Demand Scenario, in the year Yl in which reinforcement of Branch "j" is required
- $D =$ total demand (kVA) in the Network Group in the first year of the 10-year horizon in the Maximum Demand scenario
- $gl =$ annual average load growth rate corresponding to the year in which the reinforcement is expected to be required (see below)
- $T =$ 10 years over which the reinforcement cost is recovered.

In Annex 1 of Schedule 17 (EDCM), amend the definition of 'i' in Paragraph 9.2 as follows:

$i =$ discount rate, which is 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 (InputSummary sheet, Finance inputs, Vanilla allowed return on capital) prepared for the relevant DNO Party for

~~publication with such tariff setting on the DNO Party's website referred to in the ED1 Price Control Financial Handbook;~~

~~Pre-Tax Cost of Debt is set to the 'Allowed return on cost of corporate debt' value for the regulatory year for which tariffs are being set in the latest version of the PCFM (InputSummary sheet, Finance inputs, CAPM calculator tool: allowed return on debt) prepared for the relevant DNO Party for publication with such tariff setting on the DNO Party's website 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 'Allowed return on cost of equity' value for the regulatory year for which tariffs are being set in the latest version of the PCFM (InputSummary sheet, Finance inputs, CAPM calculator tool: allowed return on equity) prepared for the relevant DNO Party for publication with such tariff setting on the DNO Party's website referred to in the ED1 Price Control Financial Handbook; and~~

~~Corporation Tax Rate is set to the rate of 'Corporation tax rate' value for the regulatory year for which tariffs are being set in the latest version of the PCFM (InputSummary sheet, Tax, Tax policy) prepared for the relevant DNO Party for publication with such tariff setting on the DNO Party's website which is, when setting distribution Use of System Charges, expected to be applicable in respect of the Regulatory Year in which those Charges will take effect.~~

~~In the event of any value not being available from the above data sources, the DNO Party will prepare a forecast of the value to be used in the CC formula instead.~~

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

In Annex 2 of Schedule 17 (EDCM), amend the definition of 'i' as follows:

$i =$ discount rate, which is ~~is~~ 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 (InputSummary sheet, Finance inputs, Vanilla allowed return on capital) prepared for the relevant DNO Party for publication with such tariff setting on the DNO Party's website referred to in the ED1 Price Control Financial Handbook;~~

~~Pre-Tax Cost of Debt is set to the 'Allowed return on cost of corporate debt' value for the regulatory year for which tariffs are being set in the latest version of the PCFM (InputSummary sheet, Finance inputs, CAPM calculator tool: allowed return on debt) prepared for the relevant DNO Party for publication with such tariff setting on the DNO Party's website 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 'Allowed return on cost of equity' value for the regulatory year for which tariffs are being set in the latest version of the PCFM (InputSummary sheet, Finance inputs, CAPM calculator tool: allowed return on equity) prepared for the relevant DNO Party for publication with such tariff setting on the DNO Party's website referred to in the ED1 Price Control Financial Handbook; and

Corporation Tax Rate is set to the rate of 'Corporation tax rate' value for the regulatory year for which tariffs are being set in the latest version of the PCFM (InputSummary sheet, Tax, Tax policy) prepared for the relevant DNO Party for publication with such tariff setting on the DNO Party's website which is, when setting distribution Use of System Charges, expected to be applicable in respect of the Regulatory Year in which those Charges will take effect.

In the event of any value not being available from the above data sources, the DNO Party will prepare a forecast of the value to be used in the CC formula instead.

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

In Paragraph 2.9 of Schedule 18 (EDCM), amend the definition of 'DiscountRate' as follows:

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

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

where:

Gearing Assumption is set to the 'nNotional gGearing' value for the regulatory year for which tariffs are being set in the latest version of the PCFM (InputSummary sheet, Finance inputs, Vanilla allowed return on capital) prepared for the relevant DNO Party for publication with such tariff setting on the DNO Party's website referred to in the ED1 Price Control Financial Handbook;

Pre-Tax Cost of Debt is set to the 'Allowed return on cost of corporate debt' value for the regulatory year for which tariffs are being set in the latest version of the PCFM (InputSummary sheet, Finance inputs, CAPM calculator tool: allowed return on debt) prepared for the relevant DNO Party for publication with such tariff setting on the DNO Party's website 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 'Allowed return on cost of equity' value for the regulatory year for which tariffs are being set in the latest version of the PCFM (InputSummary sheet, Finance inputs, CAPM calculator tool: allowed return on equity) prepared for the relevant DNO Party for publication with such tariff setting on the DNO Party's website referred to in the ED1 Price Control Financial Handbook; and

Corporation Tax Rate is set to the rate of 'Corporation tax rate' value for the regulatory year for which tariffs are being set in the latest version of the PCFM (InputSummary sheet, Tax, Tax policy) prepared

~~for the relevant DNO Party for publication with such tariff setting on the DNO Party's website which is, when setting distribution Use of System Charges, expected to be applicable in respect of the Regulatory Year in which those Charges will take effect.~~

~~In the event of any value not being available from the above data sources, the DNO Party will prepare a forecast of the value to be used in the CC formula instead.~~

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

In Attachment 1 of Schedule 18 (EDCM), amend the definition of 'DiscountRate' as follows:

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

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

where:

Gearing Assumption is set to the '~~n~~Notional ~~g~~Gearing' value for the regulatory year for which tariffs are being set in the latest version of the PCFM (InputSummary sheet, Finance inputs, Vanilla allowed return on capital) prepared for the relevant DNO Party for publication with such tariff setting on the DNO Party's website referred to in the ED1 Price Control Financial Handbook;

Pre-Tax Cost of Debt is set to the '~~Allowed return on cost of corporate debt~~' value for the regulatory year for which tariffs are being set in the latest version of the PCFM (InputSummary sheet, Finance inputs, CAPM calculator tool: allowed return on debt) prepared for the relevant DNO Party for publication with such tariff setting on the DNO Party's website 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 '~~Allowed return on cost of equity~~' value for the regulatory year for which tariffs are being set in the latest version of the PCFM (InputSummary sheet, Finance inputs, CAPM calculator tool: allowed return on equity) prepared for the relevant DNO Party for publication with such tariff setting on the DNO Party's website referred to in the ED1 Price Control Financial Handbook; and

Corporation Tax Rate is set to the rate of 'Corporation tax rate' value for the regulatory year for which tariffs are being set in the latest version of the PCFM (InputSummary sheet, Tax, Tax policy) prepared for the relevant DNO Party for publication with such tariff setting on the DNO Party's website which is, when setting distribution Use of System Charges, expected to be applicable in respect of the Regulatory Year in which those Charges will take effect.

~~In the event of any value not being available from the above data sources, the DNO Party will prepare a forecast of the value to be used in the CC formula instead.~~

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