

DECISION ON THE APPEAL REGARDING A DECISION TAKEN BY THE MASTER REGISTRATION AGREEMENT (MRA) FORUM ON 6 AUGUST 2002 THAT MRA CP (MCP) 107 SHOULD NOT PROCEED

1 INTRODUCTION

- 1.1 On the 27 June 2002 the MRA Development Board (MDB) rejected MCP 107 – ‘Revise Distributor Funding Arrangements’. The originator of the change proposal was Western Power Distribution (South West). The change proposed to revise MRA Clause 8.9 (Recovery of Costs) in order to align the electricity distributor funding arrangement with that of supplier.
- 1.2 WPD submitted an appeal on the MDB decision to the MRA Forum on the 16 July 2002, in accordance with MRA Clauses 6.45 (Constitution of MEC). At a meeting on the 6 August 2002, the MRA Forum took a decision to reject the WPD appeal.
- 1.3 The Authority received an appeal from WPD to the Forum decision on the 22 August 2002, in accordance with MRA Clause 7.26 (Constitution of the MRA Forum). Whereby, a MRA party may raise an appeal where the party reasonably believes that a resolution passed by the MRA Forum will or is likely to unfairly prejudice the interests of that party, or will cause the party to be in breach of the MRA, its licence or the Electricity Act.

WPD’s appeal was lodged within the period specified in Clause 7.26 of the MRA and stated that WPD considered that the MRA Forum decision unfairly prejudiced the interest of their company.

- 1.4 The appeal is considered below. Section 2 sets out the background to the appeal. In sections 3 and 4 the arguments for and against the appeal are summarised, Section 5 discusses the issues raised and section 6 sets out the Authority’s decision. Further remarks on related matters are made in section 7.

2 BACKGROUND

- 2.1 Currently, the amount each Distribution Business (DB) is obliged to pay towards the quarterly costs incurred by MRASCo is defined under MRA Clause 8.9. The amount is calculated as follows:

$$PP = \frac{C}{14} \times \frac{1}{3}$$

where:

PP = the amount due from the DB; and

C = estimated costs for the Quarter included in the most recent budget approved by the MRA Forum (or in the event of failure of MRA Forum approval by the Authority).

- 2.2 Suppliers pay two thirds of the costs and distributors one third. The funding arrangement for suppliers is based on the number of MPANs and for distributors on an equal share per licensed distributor (n = 14).
- 2.3 MCP 107 proposes that the distributor funding be brought in line with that of suppliers, i.e. based on MPANs.

$$PP = \frac{A \times C}{T} \times \frac{1}{3}$$

where:

PP = the amount due from the DB; and

A = average number of Registered Metering Points on a Distributors MPAS Registration System across the last three months.

C = estimated costs for the Quarter included in the most recent budget approved by the MRA Forum (or in the event of failure of MRA Forum approval by the Authority).

T = the average number of Metering Points contained on all MPAS Registration Systems across the last three months.

- 2.4 WPD business justification for MCP 107 is that distributor funding needs to be reassessed to allow for new licensed distributors. They argue that current arrangements charge the same amount to all distributors irrespective of their size.
- 2.5 As previously stated WPD appealed the MRA Forum decision to the Authority. In their letter, WPD state that all proposals being addressed at the Distribution Service Providers Forum regarding distributor funding are based on continued equal share funding. They consider all such proposals to unfairly prejudice their interests. WPD state they currently contribute 14% of the distributor share of MRASCo funds despite the fact that their distribution area accounts for 10% of MPANs. WPD point out the issue has been outstanding for twelve months and

their proposed solution (MCP107) provides an “equitable solution to Distribution Licence Holder funding and recommend OFGEM to rule in favour in this matter”.

- 2.6 Ofgem, on behalf of the Authority, circulated a notice of the appeal to all MRA Parties and MRASCo (c/o Gemserv¹) on the 13 September 2002. The letter detailed the procedure Ofgem, would be adopting in determining this appeal. The procedure is based on ‘Ofgem’s Procedures for Determining Disputes Affecting Customers’. Responses to the notice were requested by the 4 October 2002. Comments on these representations by 11 October 2002.
- 2.7 Ofgem received six responses to the notice, which have been published on the Ofgem website. Five respondents (Aqulia Networks plc, EME, LE Group, NEDL/YEDL and United Utilities) were opposed to the appeal and one (Elexon) declared no interest. Ofgem received one submission from WPD commenting on the published responses.

¹ MRASCo is the company established by signatories to the MRA to be responsible for managing the day to day operation of the MRA. On the 1st September 2002 MRASCo’s personnel and operational assets transferred to Gemserv.

3 ARGUMENTS AGAINST THE APPEAL

3.1 A number of generic issues appear on the responses from the five distributors opposed to the appeal. The following is a summary on each of these issues.

3.2 MRA Voting

The respondents felt that MCP107 does not align with equivalent supplier provisions, which link funding and voting rights. They believe that distributor funding and voting are inextricably linked and that any change proposal therefore should include both elements. MCP107 is silent on voting issues.

3.3 Level of Service

The respondents state that Gemserv staff have confirmed that they provide the same level of service to all distribution companies, irrespective of size. They believe MCP107 is not cost reflective. As the primary cost driver for MRASCo is the number of parties to the MRA rather than the number of MPANs (customers connected to the network).

Aquila point out that under WPDs proposed funding methodology they would be liable for a larger share of MRASCo funding than at present, despite receiving the same service from Gemserv.

3.4 Allowed Revenue

The respondents state that the last price control took account of the existing arrangements for distributor MRA funding. LE believe that if Ofgem were to uphold WPDs appeal then the change in distributor costs will need to be reflected in the level of allowed revenues at the next price control.

3.5 Alignment with Supplier Funding

LE pointed out that suppliers are minded to seek changes to the MRA to better achieve cost reflectivity for the services they receive.

The respondents believe the argument to align with suppliers is incorrect. The nature of supplier and distributors is fundamentally different and they can see no reason why the MRA costs need be aligned. They state that suppliers operate in a fully competitive market whereas distributors operate monopoly networks with prices being set every 5 years.

3.6 New Distribution Companies

EME believe that a hybrid charging methodology would accommodate new distributors. The existing and new distributors would divide into two categories, with each category having its own charging methodology. EME recommend that the Authority directs the MRA Executive Committee to investigate a solution that will maintain the current cost reflective criteria for existing distributors and also accommodate any new small distributors.

Aquila acknowledge that new distributors would be expected to pay an equal share under the current arrangements. However, they point out that existing MRA parties would foot the bill for the new distributors MRA entry process.

Untied Utilities state that in the unlikely event equal sharing was seen as a barrier to entry, then a smaller fixed fee could be agreed for companies with a small number of MPANs.

LE in their submission state that “high barriers to entry [on new entrants to the licensed distributor market] may be a feature of participating in that market”. They also point out that “historical development [of MRA protocols] is in effect provided to new entrants for free”. LE believes that if WPD’s proposal (MCP107) were introduced, then a new distributor with a small number of supply points would pay a charge close to zero.

4 ARGUMENTS FOR THE APPEAL

4.1 The only respondent in favour of the appeal was the MCP originator/appellant WPD. The following summarises the WPD submission, which addresses the generic issues, raised by the 5 respondents.

4.2 MRA Voting

WPD do not consider it vital to link voting and funding but would have no objection were another distributor to raise an associated change proposal.

4.3 Level of Service

WPD refute the argument that equal share funding should continue as all distributors receive an equal service from MRASCo. They state it is a licence obligation to sign the MRA and they did not elect to receive these services.

They believe that a move to a system whereby MRA costs are more fairly allocated would create a level playing field. The new system would remove the unfair advantage currently afforded to larger distributors.

4.4 Allowed Revenue

WPD agree that if their appeal is successful the change in funding arrangements should be mirrored in the amount of allowed revenues at the next price control.

4.5 Alignment with Supplier Funding

In response to the LE's comment, WPD state they are not aware of any initiatives from suppliers to propose changes to the MRA.

4.6 New Distribution Companies

WPD state the proposal for a hybrid charging methodology has been discussed yet no significant progress made.

In relation to the historical development of the MRA, WPD appreciate new distributors will not incur these costs and their expenditure will be limited to entry process testing. However, WPD in their submission state that rather than penalising, the current situation safeguards WPD and other existing distributors. WPD believe that the MRA entry testing ensures new distributors do not disrupt the market. Furthermore, they feel this is a separate issue from funding and if any MRA party wants to make a change to entry processes, then they should raise a change proposal.

5 DISCUSSION

- 5.1 All respondents to the notice did not support WPD's appeal. However, a number of issues have been raised.
- 5.2 First, WPDs appeal is based on MRA Clause 7.26 which states that any resolution passed by the MRA Forum can be appealed on the grounds that a MRA party reasonably believes that it will or is likely to unfairly prejudice the interests of that party.

Currently, all the distribution businesses must pay one fourteenth of one third of the MRA costs equally. WPD have appealed on the basis that not making a change to apportion charges based on MPANs would unfairly prejudice their interests. In order for Ofgem to support the appeal we would need to believe that the portion of WPDs revenue they were allowed to collect under their price control relating to MRA charges was dependant on the number of MPANs supplied on their distribution network.

The price control allowances of the distribution network operators were set on the basis of a broad top down analysis of costs. The price controls have traditionally only identified cost items greater than £0.1 million. The cost of funding the MRA to distributors is relatively small at around £80 – 100k. Consequently, the costs would either have been identified as 'corporate overheads', 'other costs', or a 'cost of meeting the data management services obligations'. These activities were deemed to be largely fixed costs. Ofgem have indicated to companies that we would consider re-opening the price controls if there was a material change in the costs of the company. This is a principle accepted by the industry.

Based on the evidence provided by WPD Ofgem cannot support the view that rejection of their proposed modification would unfairly prejudice its interests. It is unlikely that Ofgem would consider the detailed cost implications of changing the arrangements within the price control framework. Ofgem is likely to take the approach of ensuring that the licensee has sufficient funds to meet its obligations. In general, some cost items may increase and others may fall during the course of a price control review.

In conclusion, Ofgem does not agree with WPDs view that the industry's rejection of MCP107 will unfairly prejudice their interests, as the revenue that WPD is allowed to collect under its price control in respect of these charges is independent on the size of their MPAN portfolio, and that MRA costs should be viewed as fixed costs.

- 5.3 Second, respondents stated that were Ofgem minded to determine in favour of the appeal then an associated change would need to be made to the voting arrangements. They suggested that funding and voting are linked, and that a change in the arrangements for determining the proportion of funding a party is responsible for should be reflected in voting arrangements (i.e. the level of influence an individual party has over a proposed change). The Ofgem notice letter did not seek comment on the issue of MRA voting. If any MRA party is unhappy with the current MRA voting regime they are able to raise an associated change proposal.

- 5.4 Finally, respondents believe Gemserv provides the same level of service to all distribution parties and that therefore all should bear the same level of cost for the provision of that service. For this reason the proposed funding methodology would unfairly prejudice their interests, as they would be liable to a larger share of MRASCo funding.

This argument presents certain difficulties. The individual level of service that any one party gets from being a party to the MRA is unquantified and there is no measure as to whether one party gets a greater benefit than any other. It is clear that distributors are obliged by licence to be a party to the MRA - distributors can not elect to receive the MRA services or not. It could be argued that the beneficiaries of MRA services are ultimately customers, since the purpose of the MRA is to enable competition between suppliers and therefore offer customers a choice of supplier.

However, given the current arrangements for WPD's price control and the criterion set out in Clause 7.26 that the appellant will or is likely to be unfairly prejudiced by the proposed change, this is a not a consideration upon which Ofgem can base its determination.

6 DECISION

- 6.1 Having regard to all the circumstances and for the reasons outlined above, Ofgem determines that the decision taken by the MRA Forum (that MRA CP 107 should not proceed) should stand, and WPD's appeal is rejected.

7 RELATED MATTERS

- 7.1 A hybrid solution has been noted by one distributor and could be supported by Ofgem. The solution would be for the new distributors to pay an amount of the MRA costs according to their size and the price-controlled distributors would then share the remaining costs equally.

If distributors continue to feel that their contribution to MRA charges should be based on their size, then this issue could be taken forward at the next price control.

Iain Osborne
Authorised to sign on behalf of the Authority

20 January 2003