Proposed variation:	**DCP 071 and DCP071A – Allocation of Cost to HV Connected IDNOs with LV End Users**		
Decision:	The Authority[1] directs that proposal DCP071A be made[2]		
Target audience:	DCUSA Panel, Parties to the DCUSA and other interested Parties		
Date of publication:	20 June 2011	Implementation Date:	1 October 2011

Background to the modification proposal

On 20 November 2009 we published a decision on the Common Distribution Charging Methodology (CDCM) submitted by the distribution network operators (DNOs)[3]. Our decision was to approve the CDCM subject to certain conditions and it has since been incorporated into the DCUSA. The CDCM came into effect as the basis for Use of System (UoS) charging by DNOs from 1 April 2010.

In our decision document we noted one issue with CDCM charges imposed by DNOs to other licensed distribution network operators (LDNOs)[4] that we considered should be resolved under the DUCSA open governance process. We noted that the allocation of the costs of a DNOs' high voltage (HV) network between the DNO and other LDNOs when calculating charges (the so called "HV split") was not appropriate in all circumstances. In particular we noted that this allocation is inappropriate where an LDNO was connected to the DNO HV network and the LDNO had end customers connected to its network that were LV customers. We considered the allocation inappropriate because the LDNO charges for these types of connection did not allocate any cost of the DNO HV network to the DNO[5].

The modification proposal

The proposer (GTC) raised DCP071 in August 2010. The proposal seeks to address the issue we identified in our CDCM decision concerning the allocation of HV cost in calculating LDNO charges. The proposer originally requested that DCP071 be given 'urgent' treatment as it related to a matter that was material to LDNOs. The proposer sought implementation of DCP071 on 1 April 2011. However, DCP071 did not proceed in accordance with the specified urgent timetable originally set out because of the difficulties of securing necessary data from industry parties. The Change Report was sent to us on 13 May 2011 with a proposed implementation date of 1 October 2011.

The proposal is to amend the CDCM methodology for calculating charges where an LDNO is connected to the DNO HV network and provides services to LV end customers so DNOs only charge for the proportion of HV DNO network used on average by LDNOs[6]. The proposal is to calculate this proportion as the relative HV network length provided,

[1] The terms 'the Authority', 'Ofgem' and 'we' are used interchangeably in this document. Ofgem is the Office of the Gas and Electricity Markets Authority.
[2] This document is notice of the reasons for this decision as required by section 49A of the Electricity Act 1989.
[3] DNOs are licensed distribution network operators who have a defined distribution service area. Our decision can be found on our website at the link: http://www.ofgem.gov.uk/Networks/ElecDist/Policy/DistChrgs/Documents1/CDCM%20decision%20doc%20201109%20(2).pdf
[4] LDNOs consist of DNOs and independent distribution network operators (IDNOs – who have no defined distribution services area). The CDCM LDNO charges will be used to charges IDNOs and DNOs operating out of their distribution services area.
[5] CDCM charges to LDNOs are calculated as a discount from the DNO CDCM change to an equivalent end customer. The discount is intended to reflect which network voltage tiers are provided, respectively, by the DNO and LDNO in providing distribution services to the customer.
[6] Average network used by LDNOs is taken to be the average HV network length per connection provided by LDNOs nationally divided by average HV network length per connection of the DNO in whose distribution service area the LDNO is operating. LDNOs average network lengths are assessed on a national basis to obtain a reasonably sized sample given the relatively small number of LDNO HV connections.

respectively, by the DNO and the LDNO. Two alternative proposals are put forward for calculating the average network length per connection provided by LDNOs relative to DNOs. One of these methods (DCP071) is a weighted average where the LDNO average network length is an average of the average network lengths per connection at each LDNO site. The alternative method (DCP071A) is an unweighted average which calculates LDNO average network length as total LDNO HV network divided by total LDNO HV connections. The first method is currently used in the CDCM to calculate the split of cost between DNOs and LDNOs for LDNO charges where it is connected at HV and the end customer is also connected at HV.

The Change Report suggests that DCP071A is most appropriate way to calculate average relative HV network lengths per connection. However, it notes the method used currently in the CDCM is DCP071 because this method mitigates the large impact of some unusual data observations in a small data set. The proposal recommends that DCP071A is used for the purposes of this change proposal because it is the most appropriate, and because a significantly larger dataset of LDNO HV connections is now available. Consequently the impact of unusual observations is small.

The Report notes that the impact of either DCP071 or DCP071A will be limited. Either DCP071 or DCP071A should result in more appropriate (and lower) charges to LDNOs. As LDNO charges will be lower, charges to suppliers for end customers on the DNO networks will increase to ensure that DNOs continue to recover their allowed revenue. However, because of the very small number of LDNO HV connections the impact on the charges to supplier will be very small.

The Change Report provides that both DCP071 and DCP071A better facilitate the Applicable Charging Methodology Objectives 3.2.2 and 3.2.3 though DCP071A does so better than DCP071. Although both DCP071 and DCP071A are Charging Methodology proposals, the Working Group also considered that they better facilitate general DCUSA Objectives 3.1.2 and 3.1.4.

DCUSA Parties' recommendation

DNO, LDNO/OTSO [7] and supplier parties were considered eligible to vote on this change to promote greater transparency. A separate consultation was run to ask for the view of suppliers on the proposed change as the DCUSA Panel considered that they may be materially affected even though the Working Group took a different view. However, there were no responses to this separate consultation.

In accordance with the weighted vote procedure, the recommendation to the Authority is that DCP071A is accepted. The outcome of the weighted vote is set out in the table below:

DCP071	WEIGHTED VOTING (%)							
	DNO		LDNO/OTSO		SUPPLIER		DG	
	Accept	Reject	Accept	Reject	Accept	Reject	Accept	Reject
CHANGE SOLUTION	0	100	0	100	0	100	n/a	n/a
IMPLEMENTATION DATE	0	100	0	100	0	100	n/a	n/a

[7] Offshore transmission system operators.

DCP071A	WEIGHTED VOTING (%)							
	DNO		LDNO/OTSO		SUPPLIER		DG	
	Accept	Reject	Accept	Reject	Accept	Reject	Accept	Reject
CHANGE SOLUTION	84	16	100	0	100	0	n/a	n/a
IMPLEMENTATION DATE	66	34	100	0	100	0	n/a	n/a

Respondents unanimously rejected DCP071 and its proposed implementation on 1 October 2011. LDNO and supplier parties unanimously accepted DCP071A and an implementation of this on 1 October 2011. For DNO parties, a majority (84%) supported the implementation of DCP071A and a majority (66%) supported implementation of it on 1 October 2011.

The DNO parties who voted to reject DCP071A commented that it would disproportionately reallocate costs from LDNOs to other customers given the current low volumes of LDNO networks and types of LDNO connections. Reasons given by DNO parties who voted for rejecting the proposed implementation of DCP071A on 1 October 2011 and concerns from other DNOs were that:

- it would be difficult to make a mid-year price change at this time because it would require DNOs to work with two sets of tariff models; and
- there would insufficient time to get board approval of revised charges between publication of the Authority's decision, if it is to approve either DCP071 or DCP071A, and publication of indicative charges by 30 June 2011 – the date suppliers would need to be notified of 1 October 2011 tariff changes.

We note that since the supplier consultation and the closing of voting, a supplier has made representations to us. This supplier raised a concern about the wider impact of either DCP071 or DCP071A. Their concern is that whilst the impact of DCP071 itself on charges will be small, the need for a mid-year charge change will cause DNOs to bring forward more substantial changes to manage their forecast under or over recovery of allowed revenue.

The Authority's decision

The Authority has considered the issues raised by the proposal and the Change Declaration dated 13 May 2011. The Authority has considered and taken into account the vote of the DCUSA Parties on the proposal which is contained in the Change Declaration. In making this decision we have assessed the change against the relevant DCUSA charging objectives[8]. The Authority has concluded that:

1. implementation of the change proposal DCP071A will better facilitate the achievement of the Applicable Charging Methodology Objectives; and

2. directing that the change is approved is consistent with the Authority's principal objective and statutory duties[9].

Reasons for the Authority's decision

Applicable Charging Methodology Objective 3.2.2 - 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

[8] In accordance with the DCUSA we assess the change against the relevant charging objective rather than the DUCSA general objectives as the proposed change is to a charging methodology governed by the DCUSA, in this case the CDCM.
[9] The Authority's statutory duties are wider than matters that the Panel must take into consideration and are detailed mainly in the Electricity Act 1989 as amended.

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

We consider that DCP071 and DCP071A better meet this objective because either will result in LDNO charges that reflect the fact that on average where LDNOs are connected to the DNO HV network, the LDNO provides some HV network. The change will allow LDNOs to earn margins for LV connected customers that are more commensurate with the network assets they provide. Consequently, efficient LDNOs should be able to compete more effectively to provide services to LV customers where to do so they need to connect to a DNO HV network.

DCP071 and DCP071A use average network length provided by an LDNO relative to a DNO as a proxy for the proportion of HV network assets provided by a DNO for LDNO HV connections. As we noted in our CDCM decision document we think that network length will be closely related to assets provided by each party, and therefore appropriate for use in calculating LDNO charges. We consider that that DCP071A is a better way of calculating average relative network lengths per connection because the unweighted average it uses is a more theoretically correct way of calculating it. Further we think that the significantly larger sample that is available now (around 440 LDNO connections as opposed to the sample of around 300 available at the time of the CDCM approval[10]) means that the DCP071A method is unlikely to be significantly influenced by unusual LDNO connections.

In light of the above it is our view that DCP071 and DCP071A better meet this objective, but that of the two DCP071A is the better.

Charging objective 3.2.3 - 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.

We consider that DCP071 and DCP071A will result in charges that are more reflective of the DNOs' costs because on average an HV connected LDNO will provide some HV network. Therefore, we consider that it is appropriate that DNO charges take into account the fact they will provide less HV network on average per LV end customers when the customer is connected to an LDNO network. As average relative HV network per connection will be closely related to the assets provided by a DNO, and the assets are the main driver of cost per connection, we think that it is reasonable to use this in the calculation of LDNO charges. Further, as we note above, we feel that DCP071A is a better estimate of average relative network lengths per connection.

We do not agree with the point of one DNO that the change will disproportionately reallocate LDNO costs to other customers. The point appears to be a reference to the fact that a reduction in LDNO charges will mean that charges to other customers must increase so DNOs will recover their allowed revenue. It is our view that to ensure the charges recovered from LDNOs are reflective of the costs they impose, then their charges should reflect that on average the DNO provides less HV network per LV customer when the customer is connected to an LDNO network. Further, as we explain above, we consider DCP071A is an appropriate basis for doing this. We would note that, as suggested by the Change Report, the impact on other customers will be very small as the

[10] These are numbers of LDNO network connections. The number of end customers connected to these networks will be much larger.

number of LDNO HV connections relative to the number of customers connected to DNO networks is very little[11].

Our view is that DCP071 and DCP071A better meet this objective, but that of the two DCP071A is the better.

In making our decision we have noted the concerns of a minority of DNOs regarding a 1 October 2011 implementation date for DCP071A. However we do not consider that these concerns, which relate to the practical implementation of DCP071A, should delay its implementation. We acknowledge that potentially there will be some relatively minor inconvenience for DNOs in working with two tariff models and getting board approval. However we have to set this against a potential material loss in incomes for LDNOs and the fact that it is more than eighteen months since the need for the change was highlighted in our decision document. In making our decision to approve implementation by 1 October we have also considered that that the majority of DNOs supported a 1 October implementation date.

We have also noted the concern of one supplier regarding the potential for this change to trigger substantial consequential (but not directly related) changes to charges to minimise DNO over/under recovery of allowed revenue. However, we do not consider that the implementation of DCP071A should be delayed because of this concern. We note the potential issue but again we have to balance this with the potential impact on LDNOs. Further, we consider that the industry should aim to minimise or mitigate the risk and impacts of such consequential charge changes. Our understanding is that, with the exception of one company whose plans are well known, no DNO expects to make changes to its charges in October, except as necessary to implement this modification. We would be concerned if, because of our acceptance of this modification, we saw a move from DNOs to put through additional changes to charges in October.

Decision notice

In accordance with standard condition 22.14 of the electricity distribution licence, the Authority hereby directs that modification proposal DCP071A: *'Allocation of Cost to HV Connected LDNOs with LV End Users'* be made.

Rachel Fletcher Partner, Distribution
Signed on behalf of the Authority and authorised for that purpose

11 As an idea of scale there are less than 200,000 LDNO connected customers in total compared to approximately 29 million customers connected to DNO networks. Only a proportion of the LDNO customers are connected to LDNO HV networks.