

Proposed variation:	<b>Distribution Connection and Use of System Agreement (DCUSA) DCP231: Extended PCDM under the EDCM</b>		
Decision:	The Authority <sup>1</sup> directs this modification <sup>2</sup> be made <sup>3</sup>		
Target audience:	DCUSA Panel, Parties to the DCUSA and other interested parties		
Date of publication:	8 October 2015	Implementation date:	1 April 2016

## Background

The distribution network operators (DNOs) operate 14 distribution service areas (DSAs). Independent distribution network operators (IDNOs) can own and operate smaller networks within the DSAs and provide competition for some of the distribution network activities. The charges that the IDNOs pay to DNOs for use of their distribution networks are discounted to reflect the fact that IDNOs provide the 'last mile' of the distribution network. The discount factors that are entered into the EHV (extra high voltage) Distribution Charging Model are calculated in the Extended Price Control Disaggregation Model (PCDM).

The Extended PCDM calculates a percentage split between direct and indirect costs. This split is used to allocate costs between the DNO and the IDNO at the network level where the IDNO assets connect to the DNO network. Currently, the Extended PCDM uses data in the 'RRP<sup>4</sup> 2.4' worksheet to allocate 'load related new connections & reinforcement (net of contributions)' costs ("connection and reinforcement costs") to network tiers. However, customer contributions are not split by tier and instead are allocated entirely to the low voltage (LV) level. This means that direct costs at the LV level are reduced by customer contributions, which should be allocated to the higher voltage levels.

Some parties believe the way that total connection costs are calculated and allocated to network tiers results in a distortion in the calculation of the direct/indirect cost split in favour of the upstream DNO.

GTC (on behalf of the Electricity Network Company (ENC)) raised DCP117<sup>5</sup> to correct the same issue in the PCDM, which calculates discount factors for the Common Distribution Charging Methodology. We approved DCP117 on 22 July 2015.

## The modification proposal

DCP231 was raised by the ENC and seeks to introduce the same changes to the way total connection costs are allocated to network tiers as proposed under DCP117.

The new allocation method uses data from the 'FBPQ LR1' worksheet<sup>6</sup> in the Extended PCDM to calculate connection and reinforcement costs net of customer contributions at each network tier. Customer contributions identified as relating to indirect costs are not allocated to the network tiers but contribute towards the direct/indirect cost split.

<sup>1</sup> 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.

<sup>2</sup> 'Change' and 'modification' are used interchangeably in this document.

<sup>3</sup> This document is notice of the reasons for this decision as required by section 49A of the Electricity Act 1989.

<sup>4</sup> Regulatory Reporting Pack: the method by which the DNOs have reported information to us on their performance against the regulatory framework.

<sup>5</sup> DCUSA modification proposal DCP117 (Treatment of 'Load related new connections & reinforcement (net of contributions)' in the Price Control Disaggregation Model) was approved by us on 22 July 2015. Our decision letter is here: <https://www.ofgem.gov.uk/publications-and-updates/distribution-connection-and-use-system-agreement-dcusa-dcp117-treatment-load-related-new-connections-reinforcement-net-contributions-price-control-disaggregation-model>.

<sup>6</sup> Forecast Business Plan Questionnaire: a mechanism for submitting information to Ofgem on network company performance.

Customer contributions in excess of the connection and reinforcement costs allocated to each network tier are not considered. A working group was established to assess DCP231.

### DCUSA Parties' recommendation

The Change Declaration for DCP231 indicates that all parties were eligible to vote on DCP231. In each party category where votes were cast (no votes were cast in the DG<sup>7</sup>, supplier or gas supplier<sup>8</sup> party categories) there was unanimous support for the proposal and its proposed implementation date. In accordance with the weighted vote procedure, the recommendation to the Authority is that DCP231 is accepted. The outcome of the weighted vote is set out in the table below:

DCP231	WEIGHTED VOTING (%)									
	DNO		IDNO / OTSO <sup>9</sup>		SUPPLIER		DG		GAS SUPPLIER	
	Accept	Reject	Accept	Reject	Accept	Reject	Accept	Reject	Accept	Reject
CHANGE SOLUTION	100	0	100	0	n/a	n/a	n/a	n/a	n/a	n/a
IMPLEMENTATION DATE	100	0	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 8 September 2015. 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 DCUSA Charging Objectives;<sup>10</sup> and
- directing that the modification be made is consistent with our principal objective and statutory duties.<sup>11</sup>

### Reasons for our decision

We consider this modification proposal will better facilitate DCUSA Charging Objectives 3.2.1, 3.2.2 and 3.2.3 and has a neutral impact on the other relevant objectives.

***DCUSA Charging Objective 3.2.1 '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'***

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

<sup>7</sup> Distributed Generation

<sup>8</sup> There are currently no gas supplier parties.

<sup>9</sup> Offshore Transmission System Operator

<sup>10</sup> The DCUSA Charging Objectives (Relevant Objectives) are set out in Standard Licence Condition 22A Part B of the Electricity Distribution Licence and are also set out in Clause 3.2 of the DCUSA.

<sup>11</sup> 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.

***DCUSA 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'***

The working group considered that charging objectives 3.2.1 and 3.2.2 are better facilitated by this change because it addresses a defect in the way the Extended PCDM calculates discount factors. The proposer considered that charging objective 3.2.3 is also better facilitated by DCP231.

We agree that this change proposal better facilitates charging objective 3.2.3 because taking account of all customer contributions where possible is more cost reflective than the current arrangements. In addition, we agree with the proposer that the proposed changes will have a positive effect on competition by reducing potential distortions in how the discount factors that determine the IDNOs' margins are calculated. Therefore, we also agree that DCP231 better facilitates charging objective 3.2.2, which sets out that the charging methodologies will not restrict, distort or prevent competition.

DNOs are required by their licence to set their charging methodologies in a way that supports a number of relevant objectives, including cost reflectivity and facilitating competition. As the change proposal better facilitates both charging objectives 3.2.2 and 3.2.3, we consider these improvements also enable the DNOs to better discharge their obligations under their licences and therefore the proposal also better facilitates charging objective 3.2.1.

**Decision notice**

In accordance with standard licence condition 22.14 of the Electricity Distribution Licence, the Authority hereby directs that modification proposal DCP231 '*Extended PCDM under the EDCM*' be made.

**Ian Rowson**

**Associate Partner – Regulatory Finance and Compliance**

Signed on behalf of the Authority and authorised for that purpose