

Proposed variation:	Distribution Connection and Use of System Agreement (DCUSA) DCP306 – Treatment of Ofgem Licence Fees within the Price Control Disaggregation Model		
Decision:	The Authority ¹ directs this modification ² be made ³		
Target audience:	DCUSA Panel, Parties to the DCUSA and other interested parties		
Date of publication:	27 July 2018	Implementation date:	1 April 2020

DCP306 seeks to change the Price Control Disaggregation Model (PCDM) so that the costs associated with the Ofgem licence fee are directly allocated to the Low Voltage (LV) network level.

Background

Distribution Network Operators (DNOs) calculate the use of system tariffs for customers connected to their networks through the Common Distribution Charging Methodology (CDCM). DNOs charge Licenced Distributor Network Operators (LDNOs) a discounted use of system tariff to reflect the costs that are avoided by the DNO when customers are connected to their network via another LDNO.⁴ The discount percentage applied to each DNO's tariff is calculated through the PCDM. When calculating the discount percentages for determining LDNO tariffs, some costs are directly allocated to a network level according to rules set out in Schedule 29 of the DCUSA. The remaining costs are effectively smeared across all network levels.

One such cost is associated with the Ofgem licence fee which is calculated and paid by licensees on a £ per Meter Point Administration Number (MPAN) basis. These costs are not directly allocated to a network level under the current rules, but instead smeared across all network levels using a Modern Equivalent Asset Value (MEAV) allocation driver.

It is the view of The Electricity Network Company Ltd (the Proposer) that this approach is not reflective of how the actual costs are incurred by the LDNO, as the large majority of LDNO connected customers are at the LV network level.

The Proposer considers that smearing the cost associated with Ofgem licence fees across all network levels, versus directly allocating based on the number of customers connected at each network level, results in some discount percentages that are higher (ie, the resulting LDNO tariffs are lower) than would otherwise be the case. Conversely, other discount percentages are lower (ie, the resulting LDNO tariffs are higher). In other words, the misalignment between how costs are incurred, and how they are allocated within the PCDM, results in a cross-subsidy between network levels. The Proposer considers that by allocating the Ofgem licence fee to the LV services network level only, the LDNO tariffs produced will better reflect the mechanism by which these costs are incurred.

The modification proposal

¹ 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.

² 'Change' and 'modification' are used interchangeably in this document.

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

⁴ An LDNO is an independent DNO or DNO operating an electricity distribution system outside of its 'Distribution Services Area' (see definition provided in Section 1A of the DCUSA).

The Proposer raised DCP306 on 12 July 2017. The proposal seeks to allocate the Ofgem licence fee (taken from table 2.6 of the 2007/08 Regulatory Reporting Pack (RRP)) to the LV services network level and treat it as indirect costs within the PCDM.

The proposal seeks to achieve this by inserting a new clause within Schedule 29 of DCUSA so that:

- Costs associated with 'Non-activity costs and reconciling amounts', and described in table 2.6 of the 2007/2008 RRP as "Ofgem licence fees", shall be 100% allocated directly to the LV services level.

For the avoidance of doubt, no other cost associated with 'Non-activity costs and reconciling amounts' will be allocated directly. These costs will continue to be smeared across all network levels.

The Proposer believes that allocating 100% of the costs to the LV services level is better aligned with the way in which these costs are incurred (the DCP306 working group identified that 99.8% of customers connected to a LDNO network are connected to the network at LV), and therefore better facilitates the third Applicable DCUSA Charging Objective.

The DCP306 working group requested that the DCUSA Modeller⁵ conduct an update on the PCDM to demonstrate the impacts on the consumer and LDNO tariffs when allocating the Ofgem licence fee to LV customers. The changes proposed by DCP306 were found to increase discount percentages for LV end-user demand and reduce (or leave unchanged) discount percentages in all other cases.

The increase observed on discount percentages for LV end-user demand ranges from 0.05 to 0.51%. The largest reduction in discount percentages caused by DCP306 is 0.12%; this is for HV end-user demand in the Northern Powergrid Northeast area.

The majority of the end-user tariffs are unaltered but there are some small increases (up to 0.27%) to CDCM end-user tariffs in all DNO areas. This results, in the main, in a 0.01p/kWh increase in the unit rate and a 0.001p/MPAN/day increase in the fixed charge rate.

DCUSA Parties' recommendation

Votes were cast in the DNO, Independent DNO (IDNO)/Offshore Transmission System Operator (OTSO) and Supplier party categories. The majority of DNO parties were in favour of the proposed solution. IDNO/OTSO and Supplier parties were unanimously in favour of the proposed solution. DNO, IDNO/OTSO and Supplier parties were unanimously in favour of the proposed implementation date. No votes were cast in the Distributed Generation (DG) party category. In accordance with the weighted vote procedure, the recommendation to the Authority is that DCP306 is accepted.

The outcome of the weighted vote is set out in the table below:

DCP306	WEIGHTED VOTING (%)							
	DNO		IDNO/OTSO		SUPPLIER		DG	
	Accept	Reject	Accept	Reject	Accept	Reject	Accept	Reject
CHANGE SOLUTION	92%	8%	100%	0%	100%	0%	n/a	n/a
IMPLEMENTATION DATE	100%	0%	100%	0%	100%	0%	n/a	n/a

⁵ Reckon LLP.

Our decision

We have considered the issues raised by the proposal and the Change Declaration⁶ and Change Report dated 20 May 2018. 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 Applicable Charging Methodology Objectives;⁷ and
- directing that the modification be made is consistent with our principal objective and statutory duties.⁸

Reasons for our decision

We consider DCP306 will better facilitate the third Applicable Charging Methodology Objective, and has a neutral impact on the other relevant Charging Methodology Objectives.

Third Applicable Charging Methodology Objective – that compliance with the Relevant Charging Methodology results in charges that, so far as is reasonably practicable after taking account of implementation costs, reflect the costs incurred, or reasonably expected to be incurred, by a Distribution Services Provider⁹ in its Distribution Business¹⁰

All but one voting party considered that the proposal better facilitated the third Applicable Charging Methodology Objective because the change would provide a more cost reflective mechanism for recovery of the Ofgem licence fee.

The one DNO party voting against the proposed solution did so on the grounds that they considered the proposal would weaken the cost reflectivity of the charging methodology. Their reasoning for this is that they disagree with the implication that Ofgem licence fees relate to the number of customers (or MPANs) on a licensee's network. It is their view that licence fees relate to the full scale of licensed activity undertaken by licensed parties, and the use of MPAN volumes by Ofgem is simply a proxy for the relative scale of licensed activity undertaken by network operators. They believe that it is therefore not appropriate to directly allocate the license fee costs to the LV services level, as this ignores the amount of licensed activity undertaken at other network levels.

We agree that the licence fee relates to the licensees' activities at all network levels, and directly allocating the license fee costs to the LV services level ignores licensed activity undertaken at other network levels. We consider therefore that there may be merit in allocating licence fee costs to all network levels rather than only the LV services level. This may align the way the costs are incurred and allocated within the PCDM even better than the solution proposed by DCP306. This issue was discussed by the working group, who concluded that the vast majority of LDNO connected customers are at LV and the

⁶ The Change Declaration is dated 16 May 2018.

⁷ The Applicable Charging Methodology Objectives (DCUSA Objectives) are set out in Standard Licence Condition 22A Part B of the Electricity Distribution Licence.

⁸ 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.

⁹ As defined in Standard Licence Condition 1 of the Electricity Distribution Licence.

¹⁰ As defined in Standard Licence Condition 1 of the Electricity Distribution Licence.

additional complexity of allocating licence fee costs to all network levels would outweigh any incremental benefit.

On balance therefore, while we sympathise with the DNO's comment, we consider the approach taken by DCP306 is an improvement on the current baseline. Notwithstanding this, we would expect industry to ensure this remains appropriate in the future, especially if the proportion of customers connected to LDNO networks at other network levels was to change over time.

Having considered the working group assessment and voting parties' comments, we agree that the proposal better facilitates the third Applicable Charging Methodology Objective because it will better reflect the costs incurred by LDNOs in their Distribution Businesses.

Interactions with other work

The working group and respondents to the consultation were asked to comment on possible interactions with the Targeted Charging Review (TCR) and the work being undertaken as part of Ofgem's Charging Futures Forum (CFF) and their subsequent Task Forces.

The working group highlighted that the TCR is reviewing residual charges, while the Task Forces will be covering forward-looking charges and access arrangements. The working group concluded that as DCP306 is solely focused on the PCDM, there is no direct interaction between the proposal and the TCR or the Task Forces at this time.¹¹ We agree with this conclusion but encourage industry to continue to be aware of any interactions with other work when considering future changes.

Decision notice

In accordance with standard licence condition 22.14 of the Electricity Distribution Licence, the Authority hereby directs that modification proposal DCP306: '*Treatment of Ofgem Licence Fees within the PCDM*' be made.

Chris Brown

Head of Strategy & Emerging Issues, Systems and Networks

Signed on behalf of the Authority and authorised for that purpose

¹¹ The Working Group highlighted that the TCR is reviewing residual charges, while the task forces will be covering forward-looking charges and access arrangements. As DCP306 considers only the PCDM, the workgroup considered there is no direct interaction.