

Proposed variation:	Distribution Connection and Use of System Agreement (DCUSA) Ofgem Targeted Charging Review (TCR) Implementation - DCP358: Determination of Banding Boundaries and DCP360: Allocation to Bands and Interventions		
Decision:	The Authority ¹ directs these modifications ² be made ³		
Target audience:	DCUSA Panel, Parties to the DCUSA and other interested parties		
Date of publication:	30 September 2020	Implementation date:	In accordance with Clause 11.9A(2) of DCUSA 30 September 2020

Background

In November 2019, we published our Decision (and associated Direction) on the Targeted Charging Review (TCR) Significant Code Review.⁴ Once the Decision is implemented, the costs of operating, maintaining and upgrading the electricity grid will be spread more fairly and, through reducing harmful distortions, will save consumers approximately £300m per year, with anticipated £4bn-£5bn consumer savings in total over the period to 2040.

The TCR included a review of how residual network charges are set and recovered. The aim of the TCR is to ensure that these charges are recovered from network users in a way that meets the TCR Principles:

- reducing harmful distortions,
- fairness, and
- proportionality and practical considerations.

We decided that residual charges should apply to final demand consumers only and that they will be fixed charges, with implementation of these changes in 2022. For distribution residual charges, we decided that domestic consumers should pay a single residual charge set for each licensed distribution area, and non-domestic consumers should be charged on the basis of a set of fixed charging bands, also set for each licensed distribution area. In our decision, we included provisions to review and revise (as appropriate) these charging bands and their boundaries so that the outcome of such reviews can be implemented alongside the commencement of each new electricity transmission price control. The fixed charging bands will be published at a national level and shall be set for each licensed distribution area.

Alongside our decision, we issued a Direction⁵ to the Distribution Network Operators (DNOs), to bring forward proposals to modify the Distribution Connection and Use of System Agreement (DCUSA) in relation to residual charges, to give effect to the terms of the TCR Direction.

DNOs recover their allowed revenue from their customers through distribution use of system (DUoS) tariffs. Currently, the residual component of the DUoS tariffs is added

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 https://www.ofgem.gov.uk/system/files/docs/2019/12/full_decision_doc_updated.pdf

⁵ https://www.ofgem.gov.uk/system/files/docs/2019/11/dcusa_direction_1.pdf

once forward-looking charges have been applied, to recover the remaining allowed revenue for network companies set under the price controls.

The modification proposal

Four DCUSA modification proposals were raised to implement the distribution residual charging reforms resulting from the TCR Decision. On 14 January 2020, Electricity North West raised modification DCP358 and Western Power Distribution raised modification DCP360.⁶ A Joint Working Group was set up to consider the proposed modifications together.

DCP358 determines charging bands for non-domestic distribution-connected customers. The proposal would introduce a new schedule to the DCUSA to define the residual charging bands for non-domestic users and allocate domestic users to their own single charging band. The modification sets out both the initial determination and the review process, such that the charging bands will be reviewed prior to each electricity transmission price control period.

The proposer of DCP358 believes that the modification would better facilitate two of the DCUSA Charging Objectives:⁷

- The first DCUSA Charging Objective, by ensuring DNOs are compliant with licence requirements in relation to Significant Code Reviews (SCRs), by implementing specific requirements set out in the TCR Direction.
- The second DCUSA Charging Objective, by ensuring network costs are recovered fairly from network users and to reduce harmful distortions which impact competition and efficiency of the electricity market.

DCP360 aims to develop an appropriate process to allocate customers to charging bands (as defined in DCP358), and reallocate customers to a different charging band within an electricity transmission price control period, in defined exceptional circumstances. Furthermore, it proposes a tightly-defined disputes process to ensure that market participants have the opportunity to challenge their band allocation and have it amended, where appropriate.

The proposer of DCP360 believes that the modification would better facilitate the first DCUSA Charging Objective, ensuring DNOs are compliant with their licence requirements in relation to SCRs, by implementing the specific requirements set out in the TCR Direction.

Alongside this decision, we are publishing a decision to approve related modification proposal DCP359, which covers the same new section of legal text in the DCUSA and is due to be implemented at the same time.⁸

DCUSA Parties' recommendation

In each party category where votes were cast,⁹ there was majority (>50%) support for each proposal. For the majority of party categories where votes were cast there was majority support for their proposed implementation dates. In accordance with the

⁶ <https://www.dcusa.co.uk/event/joint-dcp358-dcp360-working-group-meeting-07/>

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

⁸ *DCP359: Customers: Who Should Pay?*

⁹ There are currently no gas supplier parties.

weighted vote procedure, the recommendation to the Authority is that DCP358 and DCP360 are accepted. The outcome of the weighted votes are set out in the tables below:

DCP358	WEIGHTED VOTING (%)									
	DNO		IDNO ¹⁰		SUPPLIER		CVA REGISTRANT		GAS SUPPLIER	
	Accept	Reject	Accept	Reject	Accept	Reject	Accept	Reject	Accept	Reject
CHANGE SOLUTION	100	0	100	0	60	40	None	None	N/A	N/A
IMPLEMENTATION DATE	74	26	100	0	43	57	None	None	N/A	N/A

DCP360	WEIGHTED VOTING (%)									
	DNO		IDNO		SUPPLIER		CVA REGISTRANT		GAS SUPPLIER	
	Accept	Reject	Accept	Reject	Accept	Reject	Accept	Reject	Accept	Reject
CHANGE SOLUTION	100	0	100	0	57	43	None	None	N/A	N/A
IMPLEMENTATION DATE	74	26	100	0	40	60	None	None	N/A	N/A

Our decision

We have considered the issues raised by the proposals and the Change Declarations and Change Reports issued on 17 June 2020. We have also considered and taken into account the responses to the consultation that the Working Group issued and the votes of the DCUSA Parties on the proposals, which are attached to the Change Declarations. We have concluded that:

- implementation of the modification proposals DCP358 and DCP360 will better facilitate the achievement of the DCUSA Charging Objectives; and
- directing that the modifications be made is consistent with our Principal Objective and statutory duties.¹¹

Reasons for our decision

We consider that proposals for DCPs 358 and 360 will better facilitate the first and second Applicable DCUSA Charging Objectives, and have a neutral impact on the other relevant objectives.

First Applicable Charging Methodology Objective – that compliance with the Relevant Charging Methodology facilitates the discharge by a Distribution Services Provider¹² of the obligations imposed on it under the Act and by its licence

The Working Group unanimously agreed with the proposers that DCPs 358 and 360 would better facilitate the first DCUSA Charging Objective. The majority of DCUSA voting

¹⁰ Independent Distribution Network Operator

¹¹ 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.

¹² Distribution Services Provider: 'means any Electricity Distributor in whose Electricity Distribution Licence the requirements of Section B of the standard conditions of that licence have effect (whether in whole or in part).'

parties also agreed with this view. They highlighted that the proposals ensure DNOs are compliant with their licence requirements in relation to the SCR, by implementing the specific requirements set out in the TCR Direction. In particular, the proposals address the determination and review of charging bands for non-domestic distribution-connected customers, appropriate processes for allocation and reallocation of customers to these bands, and also covers cases of exceptional circumstances and disputes.

One DCUSA voting party stated it does not agree with the TCR Decision but acknowledged that the modification meets its intention. Another DCUSA voting party voted against this objective, believing that the TCR Decision overall does not meet any of the DCUSA objectives.

Our Position

We directed the DNOs to implement the TCR Decision by prescribing a process to determine charging bands for the payment of residual charges by non-domestic final demand consumers. In the TCR Direction, we identified four groups of non-domestic consumers that should be further divided into charging bands based on percentiles of their annual consumption or agreed connection capacity. We decided that, once allocated to a band, sites should remain within that band during each electricity transmission price control period. We also directed that the Working Group should further consider any exceptional circumstances where it may be appropriate for a site to be reallocated to a different charging band within an electricity transmission price control period. To allow customers to contest their allocation into a band, we also directed the DNOs to create a tightly-defined disputes process to ensure a route of appeal where allocation to a particular band is considered by a customer to be inaccurate.

The modifications that the Working Group brought forward have addressed the relevant parts of the TCR Direction. The Working Group examined the process for the initial allocation to charging bands, and further review of the bands for subsequent price control periods. It proposed a solution that allocates sites to charging bands based on data that is available for each consumer group, based on capacity or consumption. In addition, it agreed what will constitute exceptional circumstances sufficient to instigate reallocation to a different charging band, and it also ensured that there is a tightly-defined disputes process in place to allow for parties to challenge their banding.

Based on the above, we agree that DCPs 358 and 360 better facilitates this objective, as the Working Groups have brought forward solutions that meet the TCR Direction and the intent of the TCR Decision.

Second Applicable Charging Methodology Objective – that compliance with the Relevant Charging Methodology 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 the participation in the operation of an Interconnector

The proposer of DCP358 considered it would better facilitate the second charging objective. The proposer of DCP360 considered it would have a neutral impact against this objective.

Some members of the Working Group believed that both modifications are relevant to this objective. Of these members, a majority assessed both DCP358 and DCP360 as neutral against the second DCUSA Charging Objective, with the expectation that the

modifications would affect all parties in the same manner, therefore should not impact competition in the electricity market.

There was a minority view in the Working Group that the implementation of DCPs 358 and 360 would be detrimental to effective competition in the market, with such parties assessing these modifications as negative against this objective. They noted that suppliers may not have the residual charges following implementation of the modification proposals to accurately price customer contracts in a cost reflective manner. They considered that this may result in suppliers applying risk margins to account for this uncertainty, with the potential to affect fixed price contracts. This issue was not included in any of the statements from the DCUSA voting parties.

Those DCUSA voting parties assessing the proposals against this objective considered that the solutions proposed in DCPs 358 and 360 better facilitate the second DCUSA Charging Objective. They stated that the proposals would ensure network costs are recovered fairly from network users and reduce harmful distortions which impact competition and the efficiency of the electricity market.

Some voting parties' comments raised concerns regarding reallocation of sites to a different charging band in defined exceptional circumstances. This is intended to cover situations where significant changes at a site justify the site being reallocated to a different band within an electricity transmission price control period. In particular, one of the cases examined was changes in capacity. The Working Group agreed, further to the consultation, that significant changes in capacity of +/-50% of the capacity used at an initial allocation would allow a reallocation of a site to another band (lower or higher). The concern raised was that the 50% threshold would be very difficult for sites to meet, making it more difficult for parties to be reallocated to a different charging band within an electricity transmission price control period.

Our Position

We think that current arrangements for the recovery of residual charges are distortive and lead to network costs being disproportionately recovered from some network users. We understand that these modifications introduce a new process and that suppliers will need to make changes to their systems to ensure they allocate sites correctly to the charging bands. On balance, we consider that the benefits of removing existing distortions from residual charging arrangements will outweigh any potential additional short-term risk premia that may be associated with the implementation of these reforms. We also note that the 15-month notice period for charges will be maintained, reducing the need for any such risk premia to be applied.

In our TCR Direction, we asked that the DNOs address any disproportionate impacts for a small number of users, where changes of use have occurred resulting in a significant increase or decrease in the capacity required at the site during a fixed period prior to the next band review. In the TCR Decision we stated that a materiality threshold may be an appropriate means to achieve this. The Working Group proposed a 50% materiality threshold following consultation on different options.

As we have already stated, residual charges are cost-recovery charges, which aren't supposed to send signals for how the networks should be used. In our TCR Decision, we stated that reallocation to another band should only occur in very limited circumstances, where substantial changes in usage occur, resulting in significant changes in the level of agreed capacity required. We expect that the process of charging band reallocation within

a price control period would apply for a small number of users, to ensure that customers do not pay a disproportionate residual charge after a significant reduction or increase in their required connection capacity. As such, we believe that a 50% threshold will ensure that the changes in usage at sites that are captured in the reallocation process will be significant and the process will not include small changes in levels of usage, which could otherwise be made with the aim of changing bands to avoid residual charges.

Based on the above, we believe that DCP358 and DCP360 better facilitate this objective as their implementation would allow a fair recovery of residual charges from network users and result in the reduction of harmful distortions which impact competition.

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 Provider in its Distribution Business

The proposers and the DCUSA Parties believe that DCPs 358 and 360 are neutral against this objective. The majority of the Working Group assessed that the modifications have no impact upon this objective as they simply seek to implement charging bands and any subsequent interventions and disputes process that may be needed, rather than influencing the total value of the charges themselves.

However, there was a minority view that DCP358 negatively impacts this objective as the modification would result in changes to charges faced by customers, that are perceived as unfair and resulting from an arbitrary banding process. Such parties also argued that the lack of financial benefits to give up unrequired capacity removes the incentive of doing so.

Our Position

Our view is that the modifications are neutral against this objective. We do not share the view that the banding methodology is arbitrary, as this is in line with the TCR Decision and Direction. This was in turn based on extensive consultation carried out during the TCR, including specifically on options for banding.

We derived the bandings using a principles-based assessment against the TCR Principles. Our final banded fixed charge removes the key existing distortions, while appropriately balancing equity across bands with equality among relatively similar users within them. We recognise charges will increase for some users, but we consider this is fair and proportionate. We recognise the need to balance practicality, with the other TCR principles of fairness and reducing harmful distortions and so proposed a simplified set of bandings. Our assessment is fully-documented in the TCR Decision.

As noted in our assessment against the second DCUSA Charging Objective, we believe that residual charges are cost recovery charges, and should not send signals to users. We note that the proposals reduce any financial incentive for parties to give up unrequired capacity. This is in line with the intention of the TCR Decision, that users should not change their behaviour to avoid residual charges; any such signals should instead be sent by forward-looking charges.

Implementation of DCPs 358 and 360

The proposed implementation date of DCPs 358 and 360 was 1 August 2020, in advance of charges taking effect from 1 April 2022. This implementation date is aligned with DCP359, which covers the definitions that are required for the DCUSA legal text associated with these modifications.

A number of voting parties commented on the implementation date, with the weighted voting of the supplier parties against the proposed implementation date. The comments focused on the impact of Covid-19 and concerns covered the additional disruption to charges at an uncertain time, and the effects on patterns of consumption to the data being used to calculate the charging bands. We address Covid-19 related issues in the next section.

Another party considered that the definition of a residual charge is still under review (under our Access and forward-looking charges SCR) and implementation should be delayed until that term has been defined.¹³ While that SCR could change the scale for recovery of forward-looking charges, which may result in a consequential impact on the value of the residual charge, we do not agree that the definition of a residual charge is still under review.¹⁴

One voting party noted that it is not clear whether the impacts of the modifications on greenhouse gas emissions have been adequately assessed either relating to this modification individually, or as a result of its part in the wider TCR change process. The Working Group considered that the modifications will not have a material impact on greenhouse gas emissions and they did not carry out a further assessment. As explained in the Impact Assessment section of this letter, we are satisfied that the impact of these modifications on greenhouse gas emissions has been given due consideration in the impact assessment conducted as part of the TCR review which informed our final Decision.

We do note that the original proposed implementation date has passed. One of the reasons for delaying this decision was to allow us to consider the final proposed legal text for the equivalent Connection and Use of System Code (CUSC) modification proposals before making our decision on these modifications. Having considered the final proposed legal text for the equivalent CUSC proposals we are now able to issue our decision on these DCUSA proposals. Please note that nothing in this decision in any way fetters our discretion with respect to our decision on those CUSC modification proposals.

As the original implementation date has passed, we stipulate the implementation date is 30 September 2020 under DCUSA Clause 11.9A(2). The delay to the implementation date does not affect the planned date for these proposals to be reflected in distribution charges, from 1 April 2022.

¹³ <https://www.ofgem.gov.uk/electricity/transmission-networks/charging/reform-network-access-and-forward-looking-charges>

¹⁴ We considered potential changes to the size of the residual and undertook sensitivity analysis of this in the impact assessment that supported our TCR Decision.

Covid-19 related issues

During the Working Group discussions of these proposals, and of DCP359, several parties raised concerns around the impact of the Covid-19 pandemic on the proposals. These comments were also noted in the DCUSA parties voting statements.

In general, many industry stakeholders believe that changes in consumer demand, arising as a result of the Covid-19 pandemic, may impact the determination of charging bands and the allocation of customers to those bands, which will not be subject to review until the next electricity transmission price control period. Some stakeholders proposed delaying the implementation of the modifications. Some suggested that the data that will be used for the initial allocation of non-domestic sites to charging bands will be inaccurate, since they will be based on consumption data during the pandemic, which may not be representative of the ordinary demand of the site. It was also argued that an incorrect initial banding could result in a significant increase of disputes that would be difficult to handle promptly.

We consider that, although Covid-19 may have impacted on consumption patterns over recent months, we have not been presented with robust evidence to support how any shift in demand patterns would affect the proposals. The solution proposed aims to band sites based on data derived over an extended period of time (24 months) to ensure that the most accurate level of demand is used for banding purposes. We also note that the tightly-defined exceptions process should provide customers who have been significantly affected by the pandemic with the opportunity to demonstrate their case for changing bands, as a result of a significant and enduring change to their business activities.

Impact Assessment

Section 5A of the Utilities Act 2000 imposes a duty on the Authority (its 'Section 5A duty') to undertake an impact assessment in certain circumstances. In particular, that applies where it appears to the Authority that a proposal is important. A proposal is important for these purposes if its implementation would be likely to, among other things, "have a significant impact on persons engaged in commercial activities connected with the ... generation, transmission, distribution or supply of electricity." Where this applies, the Authority is obliged to carry out an impact assessment.

One voting party considered that there should have been an impact assessment at the Working Group stage. We conducted an impact assessment as part of our TCR Significant Code Review which was taken into consideration in our final Decision. The methodology for banding non-domestic final demand customers and the development of an exceptions and disputes process, as achieved by DCPs 358 and 360, is consistent with our TCR Decision. DCPs 358 and 360 will give effect to specific aspects of the Decision, and as such, we consider that the impact assessment conducted for the TCR Decision satisfied our obligations under the Utilities Act, with respect to these modifications.

Legal text changes

One DCUSA voting party noted that the proposed DCUSA legal text includes a minor error in paragraph 3.1:

On or before 31 March in the Regulatory Year (t-2) two years prior to the commencement of the onshore electricity transmission owner price control period (t)...

The party noted that the legal text should be amended to (t-3) instead of (t-2), to ensure that the banding process starts two years prior to the commencement of the onshore electricity transmission owner price control period (t). This is because the existing wording (t-2) would result in the banding process starting one year in advance, which would not allow adequate time for the data collection by DNOs.

We have reviewed this and agree that a housekeeping modification should be raised to change the wording of this paragraph from (t-2) to (t-3), as that would meet the intention of the process detailed in the modification.

Decision notice

In accordance with standard licence condition 22.14 of the Electricity Distribution Licence, the Authority hereby directs that modification proposals *DCP358: Ofgem Targeted Charging Review (TCR) Implementation – Determination of Banding Boundaries* and *DCP360: Ofgem Targeted Charging Review (TCR) Implementation – Allocation to Bands and Interventions* be made.

Andrew Self

Deputy Director, Electricity Access and Charging – Energy Systems Management & Security

Signed on behalf of the Authority and authorised for that purpose