



DCUSA CHANGE REPORT

DCP 123 – Revenue Matching Methodology Change

Executive Summary

DCP 123 seeks to amend the approach to revenue matching within the CDCM.

This document presents the Change Report for DCP 123 and invites respondents to vote on the proposed change.

1 PURPOSE

- 1.1 This document is issued in accordance with Clause 11.20 of the DCUSA, and details DCP 123 'Revenue Matching Methodology Change'. The voting process for the proposed variation and the timetable of the progression of the Change Proposal (CP) through the DCUSA Change Control Process is set out in this document.
- 1.2 Parties are invited to consider the proposed amendment (Attachment 1) and submit their votes using the Voting form (Attachment 2) to dcusa@electralink.co.uk by **4 July 2014**.

2 BACKGROUND

- 2.1 DCP 123 has been raised by Western Power Distribution as a result of the work of the Distribution Charging Methodologies Forum (DCMF) Methodologies Issue Group (MIG). The CP seeks to change the way revenue matching (scaling) is achieved within the CDCM.
- 2.2 Currently revenue matching is achieved by a fixed adder approach applied, at the transmission exit level, in a manner which has the effect of primarily raising the day/red unit prices. By applying scaling to peak time band consumption only, it is believed that the current CDCM could be unjustifiably distorting the economic signals provided from the pre-scaled tariff rates and could be producing excessive charges in the red/day time band.
- 2.3 A revenue matching process is required because the allowed revenue under the regulatory price control and the revenue recovered from the charging methodology are not equal. This shortfall, or excess, is to a large extent unidentified and therefore unallocated allowed income within the CDCM. As such, it has not been identified that these costs relate to peak time band consumption.
- 2.4 The intent of the Change Proposal is to determine a more cost reflective and less distortive approach to scaling and one which better facilitates the DCUSA CDCM Charging objectives. Additional information on the change can be found in the CP form provided as Attachment 3.

3 THE DCP 123 WORKING GROUP

- 3.1 The DCUSA Panel established a DCP 123 Working Group which consisted of Supplier, DNO and Ofgem representatives. Meetings were held in open session and the minutes and papers of each meeting are available on the DCUSA website – www.dcusa.co.uk.

4 CONSULTATION ONE

- 4.1 In May 2012 the DCP 123 Working Group issued a consultation document seeking industry views on DCP 123. This consultation document along with the responses received is provided as Attachment 4.
- 4.2 In the first DCP 123 consultation the Working Group sought views on two potential options for progression, which were as follows:
- **Option 1:** Take pre-scaled tariff prices and then either raise or reduce each of these individual prices by the same percentage such that allowed income is achieved.
 - **Option 2:** Apply a fixed p/kWh to all pre-scaled unit rates (i.e. take pre-scaled tariff prices and either add or subtract a fixed amount (p/kWh) to all unit rates (day, night, red, amber, green, unrestricted) such that allowed income is achieved).
- 4.3 Additional information on these proposed options and their relative benefits can be found in the consultation document provided as Attachment 4.
- 4.4 There were 11 responses received to this consultation. All consultation responses, along with the Working Group's comments and the consultation document can be found in Attachment 4. A summary of the responses received, along with the Working Group's comments, are set out below.

Question 1 - Do you understand the intent of the DCP 123?

- 4.5 The Working Group noted that all respondents understood the intent of DCP 123.

Question 2 - Are you supportive of the principles of DCP 123?

- 4.6 The following table provides summary of the responses received to this question by respondent type.

Respondent Type	Response			
	Yes	No	Other	Total
DNO	5			5
IDNO			2	2
Supplier	4			4
Total	9	0	2	11

4.7 The Working Group noted that a majority of respondents supported the change. The two respondents that did not express support for the principles of DCP 123 both suggested that more work is needed to prove the case for DCP 123, i.e. that the CP is more cost reflective than the current approach.

Question 3 - Do you consider that the proposal better facilitates the DCUSA Objectives? Please provide supporting information.

4.8 Two respondent to this question stated that they did not believe the DCUSA Objectives to be better facilitated by DCP 123. A third respondent suggested that Option 1 may potentially better facilitate the Objectives but evidence is needed to support this.

4.9 Of the respondents that agreed that both options 1 and 2 better facilitated the DCUSA Objectives, the following table lists the Objectives that they specifically mentioned as being better facilitated.

DCUSA General Objectives	No. Of Respondents that agree it is better facilitated	DCUSA Charging Objectives	No. Of Respondents that agree it is better facilitated
Objective 1	0	Objective 1	0
Objective 2	0	Objective 2	0
Objective 3	5	Objective 3	5
Objective 4	0	Objective 4	0
Objective 5	0	Objective 5	0

4.10 Note, there were three respondents that stated that the Objectives were better facilitated but did not specify which specific Objectives. These respondents are not included within the above table.

4.11 The Working Group observed that a significant proportion of the responses to consultation question three mentioned that the Change Proposal better reflects the pre-scaling cost signals.

Question 4 - Are there any alternative solutions or matters that should be considered by the Working Group?

- 4.12 Seven of the eleven respondents did not identify any alternative solutions or matters.
- 4.13 One respondent suggested that the group should consider a Distribution Charging Methodologies Forum (DCMF) Methodologies Issues Group (MIG) paper on scaling that was presented at the 14 November 2011 MIG meeting. The Working Group observed that this paper formed the basis for DCP 123.
- 4.14 An IDNO respondent highlighted that most IDNOs operate networks consisting of new housing developments so most of their Distribution Use of System (DUoS) income charges are derived from day unit charges (rate 1) and the residual from MPAN charges. The respondent had analysed the impact of DCP 123 Options 1 and 2 on its total annual revenue and found that whereas option 1 is broadly neutral in its effects option 2 will reduce the IDNO's annual income. The Working Group noted this comment and agreed that margin squeeze is an important consideration.
- 4.15 A DNO respondent highlighted that consideration will need to be given to the knock on impacts of the proposal, for example, the Annual Review Pack (ARP) may need to be updated. A Supplier respondent suggested that the Working Group should seek to avoid large changes to customer prices.

Question 5 - Are you aware of any wider industry developments that may impact upon or be impacted by this CP? If so, please give details, and comment on whether the benefit of the change may outweigh the potential impact and whether the duration of the change is likely to be limited.

- 4.16 Five respondents to this question did not identify any wider industry developments that might impact upon DCP 123.
- 4.17 Three respondents to this question highlighted that as DCP 123 impacts scaling it may have an interaction with other CDCM change proposals and open MIG issues. The Working Group agreed that this may be the case but noted that DCUSA CPs need to be assessed on their own merit.

4.18 One respondent suggested that the group should consider inclusion of other costs within the CDCM model, such as asset replacement costs. The Working Group discussed this comment and noted that the CDCM does not include all costs incurred in owning and operating a distribution network as it is an incremental cost model rather than a total cost model. Another respondent highlighted that the Distribution Charging Methodologies Forum (DCMF) Methodologies Issues Group (MIG) is reviewing the treatment of asset replacement in the CDCM.

4.19 One respondent stated that the impact on domestic customer prices should be considered in conjunction with the Retail Market Review proposals. The Working Group noted that the solution should be based on the principles, rather than the impact on customer prices.

Question 6 - Are you supportive of the proposed implementation date of 1 April 2013?

4.20 The Working Group noted that with regards to the implementation date, the general consensus was that April 13 is the preferable date. However, following the close of the first DCP 123 consultation, the rate of progression of the CP meant that it would not be feasible to meet this implementation date.

Question 7 - Do you agree that both options put forward by the Working Group are better than the baseline?

4.21 The following table provides summary of the responses received by respondent type.

Respondent Type	Response			
	Both are better than the baseline	Only Option 2 is better	It has not been demonstrated that either is better	Total
DNO	5			5
IDNO			2	2
Supplier	3	1		4
Total	8	1	2	11

4.22 The Working Group noted that the majority of respondents believe that both Option 1 or Option 2 would be better than the baseline.

Question 8 - Question 3 - Do you have a preference for Option 1 or Option 2? Please give supporting reasons.

4.23 As demonstrated by the following table there was a mixed response with regards to this question but option 1 was the option preferred by a majority of respondents.

Respondent Type	Response			
	Option 1 Preferred	Option 2 Preferred	Preference not given	Total
DNO	4	1		5
IDNO			2	2
Supplier	1	2	1	4
Total	5	3	3	11

Question 9 - It is the view of the Working Group that Option 1 maintains the relative differential between fixed and variable elements within a tariff, whereas option 2 maintains the differential between tariffs and voltage levels. Which differential do you think it important to maintain when scaling tariffs to allowed revenue?

4.24 The following table provides summary of the responses received to this question by respondent type.

Respondent Type	Response				
	Differential between Fixed and variable elements within tariff	Differential between tariffs and voltage levels	Both important	N/A	Total
DNO	2		3		5
IDNO	1			1	2
Supplier		2	1	1	4
Total	3	2	4	2	11

4.25 The Working Group reviewed the responses to this question and noted the slight preference for the approach used under Option 1. It was observed that option 1 will still have a significant proportion of scaling within the red timebands.

Question 10 - The elements included within scaling could be changed, however, the Working Group felt that this was outside of the scope of this CP but could be considered at a later date, under a different change proposal. Do you agree?

4.26 Nine respondents to this question agreed with the view of the Working Group that changing the elements within scaling was outside of the scope of the group. One respondent had no view and another suggested that the question was flawed as scaling does not contain any 'elements' but rather seeks to recover allowed revenue in a way that maintains or minimises the distortion of the cost signals.

Question 11 - Do you have any further comments on DCP 123?

- 4.27 Three respondents had additional comments in response to this question. One respondent reiterated their preference for Option 2. Another respondent suggested that consideration needs to be given to any knock-on impacts of the proposal. The third respondent stated that “the reduction of excessive peak unit rate charges for Half Hourly customers is desirable. However the accompanying disturbance to other price levels is unwelcome.”

5 DCP 123 – CONSULTATION TWO

- 5.1 Having considered the consultation comments and after further discussions, the Working Group developed a hybrid method of applying scaling which has the benefits of both Options 1 and 2. This is described by the group as the “hybrid solution”. The Working Group believes this to be a preferable solution as it maintains the pre-scaled price signal for all tariff elements including fixed and capacity charges.
- 5.2 The hybrid solution apportions the revenue to be recovered from scaling across the CDCM tariff elements in proportion to each tariff element’s share of pre-scaled revenue and then calculates a fixed adder for each tariff element to recover its apportioned scaling revenue.
- 5.3 Attachment 5 provides additional information on the hybrid solution calculation and a CDCM model which has been updated to implement this solution is provided as Attachment 6. A description of the changes made to the CDCM to implement the DCP 123 hybrid solution is provided as Attachment 7.
- 5.4 The DCP 123 Working Group decided to issue a second consultation so that market participants were given the opportunity to comment on this revised version.
- 5.5 There were 10 responses received to the second DCP 123 consultation questions. Each of the responses was reviewed and discussed by the Working Group. Two of the consultation responses were marked confidential and have not been published. All other consultation responses, along with the Working Group’s comments and the consultation document can be found in Attachment 8.

5.6 A summary of the responses received, along with the Working Group's comments, are set out below.

Question 1 - The principle that the group started with was to maintain the pre-scaled absolute differential between tariffs elements, do you agree that this is the principle that the group should take forward?

5.7 As demonstrated by the table below, the majority of respondents to this question agreed with the principle that the group proposed to take forward.

Respondent Type	Response			
	Agree	Agree it is desirable but not essential	Disagree	Total
DNO	4	2		6
IDNO			1	1
Supplier	2			2
Other			1	1
Total	6	2	2	10

5.8 One of the respondents that disagreed suggested that the principle that the group should be aiming for is to make tariffs more cost reflective. The Working Group noted that current methodology is not as cost reflective as the proposal under DCP 123, as the current methodology erodes the differential between tariffs. By not eroding the differential it makes tariffs more cost reflective.

5.9 The other respondent to disagree suggested that the group may need to seek advice on whether it is acting against competition law for a number of reasons as detailed in Attachment 8. The Working Group members, the DCUSA Panel and Ofgem considered the respondent's comments agreed that DCP 123 is not anti-competitive and thus legal advice is not required.

Question 2 - With regards to the floor price in the CDCM, should:

- **the existing floor price of zero p/KWh be kept in place?**
- **the floor price be removed, such that negative unit rates can occur where scaling is negative? Or;**
- **the floor price be changed to an alternative value (either positive or negative)?**

5.10 The following table summarises the responses to this question.

Respondent Type	Response				
	Keep at Zero	Permit Negative Vales	More Work Required	Out of Scope	Total

DNO	3	2	1		6
IDNO			1		1
Supplier	1			1	2
Other	1				1
Total	5	2	2	1	10

5.11 The Working Group noted that there was a slight majority in favour of not having negative prices. It was noted that Ofgem also had a preference for there not to be negative prices. Based on this the Working Group agreed to follow the majority view and make no change to the capping of tariffs at zero.

5.12 It was noted that if a Party did not agree with this approach then a separate change could be raised.

Question 3 - The hybrid solution applies scaling to the fixed charge, the reactive charge and the capacity charge. As the current methodology calculates these from a bottom up approach, is it appropriate to apply scaling to these charges?

5.13 Seven of the ten respondents to this question agreed that scaling should be applied to the fixed charge, the reactive charge and the capacity charge. Another respondent stated that they were comfortable with this approach but that it may be simpler to apply scaling only to the unit charges.

5.14 One respondent suggested that DCP 123 could have unintended consequences for DCP 179¹ and, as DCP 179 is addressing a more fundamental issue of the CDCM, DCP 123 should be placed on hold until Ofgem have approved/rejected DCP179. The Working Group did not agree with this suggestion and noted that having certainty on the DCP 123 solution may aid the DCP 179 Working Group.

5.15 Another respondent suggested that the group should choose its approach based on whether the method produces a reasonable answer. In response to this comment the Working Group noted that the outcome on tariffs should not define the solution.

5.16 The Working Group noted that the majority of respondents to this question support applying scaling to fixed, reactive and capacity elements.

¹ DCP 179 - Amending the CDCM tariff structure

Question 4 - Do you agree with the Working Group's proposal that the fixed and reactive elements of the Generation tariffs should be subject to scaling whilst the unit rates should not?

5.17 The following table summarises the responses to this question.

Respondent Type	Response			
	Agree	Disagree	No Comment	Total
DNO	4	2		6
IDNO		1		1
Supplier	1		1	2
Other			1	1
Total	5	3	2	10

5.18 The Working Group noted that the majority of respondents agree with the Working Group's proposal that fixed and reactive elements of the Generation tariffs should be subject to scaling whilst the unit rates should not. It was observed that all respondents support not scaling the Generation unit rates.

Question 5 - Do you agree with the proposed implementation date of 1 April 2015?

5.19 As demonstrated by the table below, the majority of respondents to this question agreed with the proposed implementation date of 1 April 2015.

Respondent Type	Response			
	Agree	Disagree	No Comment	Total
DNO	4	2		6
IDNO	1			1
Supplier	1	1		2
Other			1	1
Total	6	3	1	10

5.20 One of the respondents to disagree suggested that the interaction with DCP 179 needs to be considered. The other two respondents to disagree suggested that the implementation should be delayed so that there is a greater notice period. One of these respondents explained that the CP may impact on customer behaviour, for example, what time of day large supermarkets bake their bread and reasonable notice needs to be given to allow for this change in behaviour.

5.21 The Working Group noted the consultation responses and agreed that, given the impact of DCP 123, it would be preferable to propose an implementation date of April 2016.

Question 6 - Do you believe that DCP 123 better facilitates the DCUSA General and Charging Objectives?

- 5.22 The Working Group noted that eight of the ten consultation respondents agreed that DCP 123 improves cost reflectivity and thus better facilitates DCUSA Charging Objective 3.
- 5.23 Of the two respondents that disagreed, one suggested that the Working Group has not clearly demonstrated this. The other respondent suggested that DCP 123 would increase the difference between the cost of providing the network and the price charged for it. The Working Group disagreed with this view and considered that spreading scaling more evenly better preserves the cost message generated by the CDCM.

Question 7 - Do you have any comments on the proposed legal text?

- 5.24 Only one respondent suggested a change to the legal text, namely to make paragraph 92 clearer. The Working Group agreed with the suggested change and the legal text was updated accordingly.

Question 8 - Are there any alternative solutions or matters that should be considered by the Working Group?

- 5.25 One respondent suggested that issues with the scaling are as a consequence of more fundamental flaws, principally with the value of the CDCM, and questioned whether scaling should be carried out through scaling the 500 MW model post the treatment of 40% of indirect costs, actual reinforcement, incentives etc. The Working Group noted that this was quite different a change proposal to the intent of DCP 123. The Working Group members did not agree with the view that there is a fundamental flaw in the CDCM.
- 5.26 Another respondent suggested that applying scaling using a percentage scaler would be a far fairer, simpler and more explainable method. The Working Group observed that this suggested approach had been dismissed following the previous DCP 123 consultation as it does not improve upon the current situation (i.e. if you apply a percentage scaler to the red timeband then it has a significant impact whilst if you apply it to the green timeband it has a small impact due to the relative volumes, thus, the current issue is not addressed as the pre-scaled price signals are not maintained).
- 5.27 One respondent suggested that an alternative to the proposed solution would be for each tariff to recover the same percentage share of the allowed revenue that is recovered by

the un-scaled model. The Working Group discussed this suggestion and noted that it had the potential to introduce a distortion in the cost differentials between tariffs.

- 5.28 Another respondent suggested that the fact that there is a large discrepancy between the results of costing (where costs include a reasonable return on assets) and allowed revenues suggest that there is a mistake somewhere. The Working Group discussed this comment and noted that Allowed Revenues are set using a process that sits outside of the scope of the DCP 123 Working Group.

Question 9 - Do you have any further comments?

- 5.29 In response to this question it was suggested by one respondent that the impact on domestic tariffs should be considered. The Working Group noted that it is the principle not the result on prices that should drive the solution.
- 5.30 One respondent suggested that the cumulative impact of DCP 123 and other CDCM changes that are currently in progress should be considered. The Working Group noted that Ofgem has always advised that changes should be considered in isolation.
- 5.31 Another respondent suggested that DCP 123 should be placed on hold until DCP 179 has further progressed as the DCP 123 proposed solution could impact some tariffs more than others and increase the discrepancy between NHH and HH tariffs that DCP179 is trying to remove. The Working Group discussed this comment and noted that there are other CPs, such as DCP 169², waiting for DCP 123 to progress. The group agreed to proceed with DCP 123, rather than placing it on hold.

6 DCP 123 WORKING GROUP ASSESSMENT

- 6.1 The DCP 123 Working Group discussed the proposal over a number of meetings, taking into account the responses received to the two DCP 123 industry consultations. The topics discussed by the Working Group and the group's conclusions are detailed below.

Choice of Solution

² DCP 169 - Seasonal Time of Day (SToD) HH Metered Tariffs in the CDCM

6.2 The solution put forward within the DCP 123 legal text, which is described by the group as the hybrid solution, is the third solution developed by the Working Group. The group has assessed the potential solutions and believes that each has the following advantages and disadvantages **when compared to the baseline**, (i.e. the fixed £/kW/year adder currently applied at the transmission exit level, as detailed in paragraphs 92 to 93 of Schedule 16 of the DCUSA).

Option 1 – Percentage Scaler: Take pre-scaled tariff prices and then either raise or reduce each of these individual prices by the same percentage such that allowed income is achieved	
Advantages	<ul style="list-style-type: none"> • This approach will make the tariffs less volatile. • This approach reduces the amount of revenue recovered from the unit element of the charges, which is most susceptible to environmental and economic influence, hence means that levels of under/over-recovery should be more predictable.
Disadvantages	<ul style="list-style-type: none"> • This option does not maintain the cost differential between tariffs and voltage levels. • The level of distortion of the economic cost differential between tariffs and voltage levels increases as the level of revenue reconciliation increases.
Option 2 – Fixed Adder: Apply a fixed p/kWh to all pre-scaled unit rates (i.e. take pre-scaled tariff prices and either add or subtract a fixed amount (p/kWh) to all unit rates (day, night, red, amber, green, unrestricted) such that allowed income is achieved).	
Advantages	<ul style="list-style-type: none"> • This approach maintains the economic cost differential between tariffs and voltage levels. • This approach will make the tariffs less volatile. • By applying revenue matching to all units rather than just the red timeband/day units this approach will be more predictable than the current approach. Therefore levels of under/over-recovery should be more predictable. • The current approach to scaling uses a fixed adder at the GSP level, which has the effect of scaling being predominantly affecting the red timeband. It has not been proven that the unscaled tariffs relate to peak demand, thus undue weight is currently being placed on the peak timeband.
Disadvantages	<ul style="list-style-type: none"> • Option 2 only applies scaling to unit rates and is therefore no advantage to the baseline in this respect. Revenue recovered through scaling is to a large extent unallocated and unidentified and therefore should apply to all tariff elements. • There is a small, immaterial, distortion in the differential in instances where negative scaling occurs and the base price is low to begin with and the final price is artificially capped to zero.

Hybrid of Options 1 and 2: Apportions the revenue to be recovered from scaling across the CDCM tariff elements in proportion to each tariff element's share of pre-scaled revenue and then calculate a fixed adder for each tariff element to recover its apportioned scaling revenue.	
Advantages	<ul style="list-style-type: none"> • This approach maintains the economic cost differential between tariffs and voltage levels. • This approach will make the tariffs less volatile. • By applying revenue matching to all tariff elements rather than just the red timeband/day units this approach will be more predictable than the current approach. Therefore levels of under/over-recovery should be more predictable. • The current approach to scaling uses a fixed adder at the GSP level, which has the effect of scaling being predominantly affecting the red timeband. It has not been proven that the unscaled tariffs relate to peak demand, thus undue weight is currently being placed on the peak timeband.
Disadvantages	<ul style="list-style-type: none"> • There is a small, immaterial, distortion in the differential in instances where negative scaling occurs and the base price is low to begin with and the final price is artificially capped to zero.

6.3 The Working Group notes that the hybrid option, when compared to options 1 and 2 best preserves the pre-scaled incremental cost signals created by the CDCM across all tariff components. The Working Group has therefore chosen to take forward the hybrid solution under DCP 123.

What does scaling represent?

6.4 Scaling is the difference between the forward looking incremental cost and the target allowed revenues that the DNOs are permitted to recover through the price control.

6.5 The CDCM is not a total cost model (i.e. one which includes and allocates all DNO costs) but has rather been designed to give a forward looking incremental cost message to users of the network. The CDCM includes the costs which have been deemed to be relevant for the purposes of calculating this incremental cost message and all other costs have therefore been excluded and deemed to be not relevant for creating a forward looking cost message. These other costs are to a large extent unidentified but are known to include such things as asset replacement and a 40% portion of indirect costs.

- 6.6 The Working Group agrees that DCP 123 should seek to preserve the pre-scaled differential between tariff elements as calculated by the CDCM, and so preserve the cost signals provided by the incremental cost modelling, rather than see to identify and allocate any of the costs intentionally excluded from the modelling.
- 6.7 The Working Group notes that despite excluding some significant elements of DNO costs, the pre-scaled tariffs currently calculated by the CDCM still result in a requirement for negative scaling in some DNO areas i.e. the application of the incremental cost tariffs currently recovers more than the total costs of the DNO in some areas.

Negative Scaling

- 6.8 Under the proposed DCP 123 solution, some of the unit rate tariffs become zero in those distribution areas where there is negative scaling. This occurs because in areas with negative scaling the unit rate tariffs are scaled downwards. Those rates that are relatively low to begin with are scaled by an amount which could be large enough to take them to zero or below. The CDCM model does not permit negative demand tariffs and therefore the rates are capped at a floor price of 0p/kWh.
- 6.9 The Working Group observed that if prices were permitted to be negative then it might imply that putting energy onto the network at that point in time is benefiting the Distributor. The Working Group had a concern that this might not be the appropriate signal to give as the negative price would be the result of the scaling rather than because this was the cost signal produced by the model. Counter to this, if there is a floor price of 0.000 p/kWh this means that the pre-scaled differential between tariffs may not be maintained in all instances which works against the principle that the group is seeking to achieve, i.e. to maintain the pre-scaled absolute differential between tariff elements.
- 6.10 The Working Group members considered whether tariffs should be permitted to become negative or whether they should continue to be capped at 0.000p/kWh and noted that they could see the benefits of each option and sought the view of industry participants on their preferred option, i.e. allowing negative prices or having a floor price of 0.000p/kWh. Based on the responses received the Working Group agreed to follow the majority view and make no change to the current approach of capping of tariffs at zero.

- 6.11 It was noted that at present LPN is the only affected DNO area due to the impact of negative scaling. However, future CDCM changes (for instance, if asset replacement were to be included within the CDCM) and reductions in allowed revenue through RIIO-ED1 will increase the likelihood of negative scaling occurring. Therefore, if DCP 123 is implemented there may be other DNO areas also affected in the future.

Scaling of Generation Tariffs

- 6.12 The Working Group noted that although Generation tariffs are not currently scaled, under DCP 123 the fixed rate and reactive elements of the Generation tariffs will be scaled. Generation unit rates will continue not to be scaled. The Working Group believes that this is the correct approach as the unit rate relates to a benefit and thus should not be scaled whilst the fixed and reactive elements are associated with a cost. It is important not to overstate the credits as we do not wish to give the wrong incentive to generators. However, costs need to be allocated fairly and reflect scaling to enable DNOs to achieve their allowed revenue.
- 6.13 In Ofgem's decision letter on the CDCM Ofgem noted that justification for the decision to exclude distributed generators from scaling was not provided. In its letter Ofgem noted that there was no obvious reason why DGs should be excluded from this mechanism. DNOs were asked by Ofgem to review the decision to exclude distributed generators from scaling and address this under open governance.

Impact on the Annual Review Pack

- 6.14 The Working Group notes that DCP 123 affects the Annual Review Pack (ARP) in the sense that it contains the CDCM model, thus any change to the CDCM model will impact upon the ARP. The ARP itself will not look any different but the calculations within it will change. An updated ARP is provided as Attachment 9.
- 6.15 In the ARP provided as Attachment 9 some small differences between how the CDCM and ARP deal with rounding has been identified. Although it has been agreed that as the ARP is solely a forecast model, and not a charging model in the way the CDCM is, these issues

are not material. A separate review to align the ARP with the CDCM will be taken forward, as it was considered outside of the scope of DCP123.

7 IMPACT ASSESSMENT

- 7.1 The updated CDCM model has been used to carry out an impact assessment on the proposed hybrid solution using April 2014 charges; this impact assessment is provided as Attachment 10 and shows the impact on revenue, tariffs and an average bill.

8 ENGAGEMENT WITH THE AUTHORITY

- 8.1 Ofgem has been fully engaged throughout the development of DCP 123 as a member of the Working Group.

9 ASSESSMENT AGAINST THE DCUSA OBJECTIVES

- 9.1 The Working Group has identified that DCP 123 better facilitates the following DCUSA Objectives.

Charging Objective 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.

- 9.2 The current approach to scaling is predicated on the assumption that unallocated costs are driven by peak demand and this is no longer believed to be correct. Costs such as asset replacement (which are not currently allocated) are not entirely driven by peak demand as assets will be required to be replaced to service all levels of demand. The proposed approach will apportion these costs on a much more equitable basis.
- 9.3 By allocating unallocated allowed revenue across each of the different charging elements of the tariff rather than primarily into one time band – ensuring that the unit costs in those peak time bands (day or Red unit rates) better reflect the underlying cost message and are less likely to be unduly excessive.

- 9.4 Scaling should seek to ensure that allowed revenue targets are recovered with as little impact as possible on the incremental cost signals provided by the pre-scaled tariffs. Unlike the current method of scaling, the DCP 123 hybrid approach maintains the pre-scaled cost differentials between tariffs and voltage levels and therefore ensures that the final tariffs better reflect the incremental cost signals provided by the pre-scaled tariffs.

Charging Objective 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)

- 9.5 There is a small improvement against this objective as applying revenue matching to all tariff elements rather than just the red timeband/day units should result in more predictable revenue forecasting than the current approach. Therefore, levels of over and under recover, and their impact on future tariffs, should be more predictable.

10 IMPACT ON GREENHOUSE GAS EMISSIONS

- 10.1 In accordance with DCUSA clause 11.14.6, the Working Group assessed whether there would be a material impact on greenhouse gas emissions if DCP 123 were implemented. The Working Group did not identify any material impact on greenhouse gas emissions from the implementation of this Change Proposal.

11 DCP 123 LEGAL DRAFTING

- 11.1 The proposed legal text is provided as Attachment 1. This legal text implements the hybrid solution but does not make any changes to the current CDCM demand tariff floor price.

12 IMPLEMENTATION

- 12.1 The proposed implementation date for DCP 123 is 1 April 2016. This date has been chosen to allow for a sufficiently long notice period.

13 PANEL RECOMMENDATION

13.1 The Panel approved this Change Report on 18 June 2014. The Panel considered that the Working Group had carried out the level of analysis required to enable Parties to understand the impact of the proposed amendment and to vote on DCP 123.

13.2 The timetable for the progression of the Change Proposals is set out below:

Activity	Date
Change Report approved by DCUSA Panel	18 June 2014
Change Report issued for voting	20 June 2014
Voting closes	4 July 2014
Change Declaration	8 July 2014
Authority Decision	12 August 2014
DCP 123 Implemented	1 April 2016

14 NEXT STEPS

14.1 Parties are invited to consider the proposed amendment (Attachment 1) and submit their votes using the Voting form (Attachment 2) to dcusa@electralink.co.uk by **4 July 2014**.

14.2 If you have any questions about this paper or the DCUSA Change Process please contact the DCUSA by email to dcusa@electralink.co.uk or telephone 020 7432 2842.

ATTACHMENTS

- Attachment 1– Legal Text
- Attachment 2– Voting Form
- Attachment 3 – DCP 123 CP Form
- Attachment 4 – Consultation One Documentation
- Attachment 5 – Hybrid Solution Description
- Attachment 6 – DCP 132 Updated CDCM
- Attachment 7 – Description of CDCM Changes
- Attachment 8 – Consultation Two Documentation
- Attachment 9 – DCP 123 updated Annual Review Pack
- Attachment 10 – Impact Assessment