



DCUSA Consultation

DCP 228 - Revenue Matching in the CDCM

1 PURPOSE

- 1.1 The Distribution Connection and Use of System Agreement (DCUSA) is a multi-party contract between electricity Distribution Network Operators (DNOs), Electricity Suppliers and large Generators. Parties to the DCUSA can raise Change Proposals (CPs) to amend the Agreement with the consent of other Parties and (where applicable) the Authority.
- 1.2 This document has been issued to all DCUSA Parties and the Authority, in accordance with Clause 11.14 of the DCUSA, seeking industry views on DCP 228.
- 1.3 Parties are invited to submit comments using the form provided in Attachment 1 to DCUSA@electralink.co.uk by **18 May 2015**.

2 DCP 228 - REVENUE MATCHING IN THE CDCM

- 2.1 DCP 228 has been raised by British Gas. The CP seeks to change the way revenue matching (scaling) is achieved within the CDCM so that the price differentials produced between the pre-scaled yardstick tariff unit rates are maintained in the post-scaled final tariff unit rates that are set to enable recovery of the DNO's allowed revenue. Currently this revenue matching is achieved in a manner which primarily affects only the day/red unit prices which distorts the unit rate differential. This change proposal seeks to replace the current method of revenue matching such that all unit rates face the same absolute p/kWh adjustment (except where any unit rates are subject to a floor price).
- 2.2 The proposed DCP 228 solution is to remove the fixed £/kW/year adder currently applied at the transmission exit level, as detailed in paragraphs 92 to 93 of Schedule 16, and replace this with a fixed p/kWh applied to the calculated pre-scaled unit rates. The current CDCM does not apply scaling to generation tariffs and applies a floor price to demand tariffs of 0.000p/kWh. Under DCP 228 both of these rules will be maintained.

- 2.3 Additional information on the CP is contained within the CP form provided as Attachment 2.

3 WORKING GROUP ASSESSMENT OF DCP 228

- 3.1 The DCUSA Panel established a Working Group to assess DCP 228. The group consists of Distributor, Supplier and Ofgem representatives. The topics discussed by the Working Group are detailed below.

4 RELATED CHANGE DCP 123

- 4.1 The DCP 228 Working Group noted that DCP 123 'Revenue Matching Methodology Change' also sought to change the method of scaling in the CDCM to one which better maintained the incremental cost signals of the CDCM. This CP was rejected by the Authority on 12 August 2014. The DCP 123 Authority Decision letter and Change Report are provided as Attachment 3.
- 4.2 In rejecting DCP 123 the Authority felt the change failed to demonstrate that scaling has been spread in a more cost reflective way, and that without a detailed comparison of costs determined through the 500MW model and costs allowed for in the price control it wasn't possible for the Authority to be sufficiently satisfied that the change was more cost reflective. The Authority did, however, recommend that the industry develop the proposal further.
- 4.3 It is the view of the proposer of DCP 228 that, in retrospect, DCP 123 failed to adequately explain the purpose of scaling applied to the incremental cost signals. For instance the DCP 123 change proposal form explained scaling as a shortfall or excess which is *"to a large extent unidentified and therefore unallocated allowed income within the CDCM"* and that, *"as such, it has not been identified that these costs relate to peak time band consumption"*. This implies that DCP 123 was attempting to 're-allocate' costs away from peak time and, in this context, more evidence would be required if considering cost allocation. However, DCP 228 is not seeking to allocate overall costs, as this is not appropriate or possible within an incremental model, and so Ofgem's reason for rejecting DCP 123 should not apply to this proposal.

- 4.4 DCP 228 is intended to be clearer in explaining that the shortfall or excess of revenue recovered from pre-scaled yardstick tariffs is a natural consequence of the incremental design of the CDCM. As the accompanying spreadsheet (Attachment 4) demonstrates, the CDCM recovers significantly more in peak charges than DNOs expect to spend on network reinforcement for the foreseeable future. This is because the CDCM provides incremental cost signals rather than total cost signals. Similarly, there are DNO costs which are not included in the CDCM (such as replacement costs and a portion of indirect costs), however these are not 'unidentified' as the DCP 123 form suggested, but rather they are **intentionally** excluded from the CDCM for the purpose of deriving the desired incremental cost signals. This change proposal is therefore clear in its intent that scaling should not be used to allocate any cost not included within the CDCM, but should rather be applied in a way which maintains the incremental cost signals produced by the pre-scaled tariffs.
- 4.5 DCP 228 also follows on from the final DCP 123 solution in maintaining the fixed adder approach to scaling unit rates. The options for this were discussed in the course of DCP 123, with the alternative being a percentage scalar on unit rates. The DCP 228 Working Group discussed this, and agreed that the fixed adder approach agreed in DCP 123 remains appropriate. This is because of the incremental nature of the CDCM, with the absolute difference between pre-scaled unit rates representing the cost differential of distributing at different times. A fixed adder would maintain this cost signal differential in the resulting scaled tariff's unit rates, whilst a percentage scalar could potentially distort the differential in the unit rates.
- 4.6 For example, pre-scaled tariffs of 2 p/kWh for consumption in a peak time band compared to 1 p/kWh for consumption in an off-peak time band could either be scaled to 5 p/kWh and 4 p/kWh under a fixed adder approach, or potentially 6 p/kWh and 3 p/kWh under a percentage scalar approach. The first of these maintains the 1 p/kWh absolute differential between pre-scaled tariffs, maintaining the intended signal that it costs the DNO 1 p/kWh more to distribute in the peak band than the off-peak, whilst the second would distort this cost signal by implying that the cost to the DNO of distributing in the peak band is 3 p/kWh higher than in the off-peak band.

5 INTERACTION WITH DCP 179

- 5.1 The DCP 228 Working Group noted that approved Change Proposal DCP 179 'Amending the CDCM tariff structure' will result in Time of Use signals being more widely used within the CDCM. This increases the importance of ensuring that the economic signal of the incremental models are not distorted by scaling, as this could lead to inefficient actions being taken by users.

6 UPDATED CDCM MODEL

- 6.1 The Working Group updated the CDCM model to reflect the proposed solution. The updated model is provided as Attachment 5 along with a description of the changes made.
- 6.2 When applying the DCP 228 solution to the CDCM, the Working Group used a baseline model which incorporated both of the following approved DCUSA CPs:
- DCP 179 'Amending the CDCM tariff structure' – this CP was implemented on 1 April 2015
 - DCP 161 'Excess Capacity Charges' - this CP has been approved for implementation on 1 April 2016
- 6.3 The reason for this is that the earliest that DCP 228 could be implemented is 1 April 2016, by which time both DCP 179 and DCP 161 will have been implemented.

7 IMPACT ASSESSMENT

- 7.1 The Working Group noted that the CDCM tariffs for the 2015/16 charging year do not incorporate DCP 161. It would therefore not be appropriate to compare the results of the DCP 228 updated CDCM model with the tariffs for the 2015/16 charging year. The Working Group instead prepared the impact assessment on a 2016/17 tariff basis. The impact assessment includes the following tariffs:
- Baseline 2016/17 tariffs (calculated using a CDCM model that includes DCP 179 and

DCP 161)

- DCP 228 2016/17 tariffs (calculated using a CDCM model that includes DCP 179, DCP 161 and the proposed DCP 228 solution)
- 7.2 This impact assessment is provided as Attachment 6 and shows the impact on revenue, tariffs and an average bill.
- 7.3 The Working Group notes the impact of DCP 228 is broadly similar across all DNO areas with the exception of where the scaling is negative. When negative scaling occurs, it can result in Unit Rate prices of 0.000 p/kWh. This occurs because in areas with negative scaling the unit rates are scaled downwards. Those rates that are relatively low to begin with are scaled by an amount which is 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 0.000 p/kWh.
- 7.4 In the DCP 228 impact assessment UK Power Networks' London Power Networks is the only DNO area that currently has negative scaling. However, the Working Group noted that future CDCM changes (for instance, if asset replacement were to be included within the CDCM) may increase the likelihood of negative scaling occurring. Therefore, if DCP 228 is implemented there may be other DNO areas also affected in the future.

8 THE CDCM FLOOR PRICE

- 8.1 The Working Group noted that industry parties were consulted on whether there should be a floor price during the progression of DCP 123. The DCP 123 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 DCP 123 Working Group was concerned 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, it was noted that a floor price of 0.000 p/kWh means that the pre-scaled differential between tariffs would not be maintained which would work against the principle of the proposal.
- 8.2 Amongst respondents to the DCP 123 industry consultation there was a slight majority in

favour of not having negative prices. Although at the time Ofgem indicated a preference for there not to be negative prices, they are open to re-evaluating this, in light of any evidence presented by industry. The responses to the DCP 123 consultation are included within the DCP 123 Change Report, which is provided as Attachment 3.

- 8.3 The DCP 228 Working Group has agreed that this area should not be re-opened under DCP 228 and that the decision of the DCP 123 Working Group to retain the floor price of 0.000 p/kWh should stand.
- 8.4 When making this decision the DCP 228 Working Group carried out analysis using data from London Power Networks model to check that even with a floor price of 0.000p/kWh, DCP 228 tariffs better maintain the pre-scaled differential than the current baseline approach. This analysis is provided as Attachment 7. Note, the baseline (pre-scaled) charges are taken from the final 2015/16 CDCM model and so have not been updated to reflect the changes to some input values under DCP 161, this explains some of the unexpected small differences to other tariff elements (e.g. fixed charge).

9 ASSESSMENT AGAINST THE DCUSA OBJECTIVES

- 9.1 For a DCUSA Change Proposal to be approved it must be demonstrated that it better meets the DCUSA Objectives. There are five General DCUSA Objectives and five Charging Objectives. The full list of objectives is documented in the CP form provided as Attachment 2.
- 9.2 The Working Group has assessed the CP against the DCUSA objectives and the Working Group members agree that the following DCUSA Objectives are better facilitated by DCP 228.

Charging Objective Three – 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

- 9.3 The Working Group has identified that DCP 228 better facilitates DCUSA Charging Objective Three. The incremental cost signals produced by the pre-scaled tariffs in the CDCM are

currently distorted by applying scaling primarily into one time band. By allocating unallocated allowed revenue across each of the unit rates on a fixed adder basis, this change improves cost reflectivity by maintaining the incremental cost differential between unit rates across all tariffs and all timebands. The change also ensures that the unit costs in peak time bands (day or Red unit rates) will better reflect the underlying cost message by virtue of being distorted less than the current method of scaling.

10 IMPLEMENTATION

10.1 The proposed implementation date for DCP 228 is 1 April 2016.

11 PROPOSED LEGAL TEXT

11.1 The proposed legal text is provided as Attachment 8.

12 CONSULTATION

12.1 The Working Group is seeking views on the below consultation questions:

1. Do you understand the intent of the CP?
2. Are you supportive of the principles of DCP 228?
3. Do you agree with the proposal to not allow negative demand tariffs, by setting a floor price of zero p/KWh? Please provide your rationale.
4. Do you consider that the proposal better facilitates the DCUSA objectives? Please give supporting reasons.
5. Do you have any comments on the proposed legal text?
6. Are you supportive of the proposed implementation date of April 2016?
7. Are there any alternative solutions or matters that should be considered by the Working Group?

- 12.2 Responses should be submitted using Attachment 1 to DCUSA@electralink.co.uk no later than **18 May 2015**.
- 12.3 Responses, or any part thereof, can be provided in confidence. Parties are asked to clearly indicate any parts of a response that are to be treated confidentially.

13 NEXT STEPS

- 13.1 Following the end of the consultation period the responses will be reviewed by the Working Group. The Working Group will then determine the progression route for the CP.
- 13.2 If you have any questions about this paper or the DCUSA Change Process please contact the DCUSA Help Desk by email to DCUSA@electralink.co.uk or telephone 020 7432 2842.

14 ATTACHMENTS

Attachment 1 – Response form

Attachment 2 – CP Form

Attachment 3 – DCP 123 Authority Decision letter and Change Report

Attachment 4 – DCP 228 example spreadsheet

Attachment 5 – DCP 228 updated CDCM Model and description of changes.

Attachment 6 – Impact Assessment

Attachment 7 – LPN Floor Price Analysis

Attachment 8 - Draft Legal Text