



DCUSA CONSULTATION

DCP 180 - Further Reduction in the Volatility of Use of System Charges

1 Purpose

- 1.1 The Distribution Connection and Use of System Agreement (DCUSA) is a multi-party contract between electricity Distributors and 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) Ofgem.
- 1.2 This document is a Consultation issued to Distributors, Suppliers, Consumer Focus, Ofgem and other interested Parties seeking industry views on DCP 180 'Further Reduction in the Volatility of Use of System Charges'. You are invited to consider the questions set out in section 8 below and submit comments using the form attached as Appendix A to dcusa@electralink.co.uk by **25 September 2013**.

2 Background

- 2.1 The Common Distribution Charging Methodology (CDCM) sets out how Distribution Network Operators (DNOs) should calculate the charges for use of their distribution networks, known as Distribution Use of System (DUoS) tariffs. The CDCM applies only to consumers connected at Low Voltage (LV) and High Voltage (HV) levels; separate charging methodologies exist for Extra High Voltage connected consumers. The CDCM is defined within DCUSA (Schedule 16) and the CDCM model is a spreadsheet used by all DNOs to calculate HV and LV DUoS tariffs in line with the methodology set out in Schedule 16¹.
- 2.2 The method used to calculate DUoS tariffs is intended to enable DNOs to recover their allowed revenue for the charging year, as set by Ofgem, in a cost reflective manner.
- 2.3 DCP 180 has been raised by Electricity North West and seeks to lock down the CDCM model for a period of up to five years, such that tariffs are not recalculated. The CP would also introduce a mechanism that will enable DNOs to amend the CDCM tariffs by applying an additional scaling factor to all tariffs to ensure the DNO recovers its allowed revenue within the charging year. For

¹ You can find the latest CDCM spreadsheet for each DNO licence area on the following webpage: <http://www.energynetworks.org/electricity/regulation/duos-charges/common-distribution-charging-methodology.html>

the avoidance of doubt, this CP does not apply to the EHV Distribution Charging Methodology (EDCM).

- 2.4 The proposer of DCP 180 notes that currently a small change to a DNO's allowed revenue can result in a large and volatile change in some elements of the DUoS tariffs, with some tariffs increasing and others decreasing. Suppliers, especially niche Suppliers, and consumers are exposed to this volatility. DCP 180 has been raised to reduce this volatility while still enabling DNO's to recover their allowed revenue.
- 2.5 The DCP 180 Working Group noted that there are various drivers of volatility in DUoS charges (for instance, revenue changes, changes to volumes and changes to the charging methodology). DCP 180 will address only the volatility associated inputs and possibly changes to the charging methodology, depending on the responses to this consultation.

3 DCP 180 'Further Reduction in the Volatility of Use of System Charges'

- 3.1 The existing CDCM methodology contains a demand scaling methodology to ensure that within year tariffs recover the allowed revenue. This proposal will introduce an additional scaling factor. This new scaling factor will be a simple percentage value that will be applied to all tariffs. To differentiate between the two types of scaling the following terminology is adopted within this document:
- Primary scaling factor: The demand scaling methodology that is currently used within the CDCM model.
 - Secondary scaling factor: The additional scaling factor that is applied to tariffs after the CDCM Methodology has been locked down to ensure DNOs still recover their allowed revenue.

- 3.2 The CP will amend the CDCM Methodology to introduce secondary scaling. The two drivers of the secondary scaling factor will be changes to the volume forecasts and changes to allowed revenue.
- 3.3 The secondary scaling could be applied to all elements of a tariff or to a single component, such as the unit rates only.
- 3.4 As part of the DCP 180 legal text, a requirement will be placed on DNOs to provide their latest view of the secondary scaling factor each quarter with their DCUSA Schedule 15 publications.

Discussion of the Options

Option 1 – One Model with One Set of Tariffs for the Agreed Period

- 3.5 The first option for implementing this proposal is to publish one CDCM model with one set of tariffs that will apply for the agreed period.
- 3.6 This option is the simplest and most transparent option. However, if the allowed revenue changes significantly between regulatory years (such as the revenue profiling that was adopted across DPCR5), the secondary scaling factor that would need to be applied in each year to take account of this would also vary substantially. If the secondary scaling factor applied by DNOs started to become material, this would effectively mean that the secondary scaling factor becomes a large driver of tariffs and consequently a substantial part of the methodology.
- 3.7 This is illustrated in the table below. In this example, a four year CDCM model has been issued that covers the period 2016-2020. This model has an average annual allowed revenue of £100m and generates a domestic tariff of 3p/kWh. The table shows the calculation of the secondary scaling factor to take account of the profiling of the allowed revenue and the impact on the domestic tariff.

Year	2016/17	2017/18	2018/19	2019/20
CDCM Model - Allowed Revenue (£m)	100	100	100	100
CDCM Model - Domestic Tariff (p/kWh)	3.00	3.00	3.00	3.00
Actual Allowed Revenue (£million)	70	90	110	130
Secondary Scaling Factor	-30%	-10%	+10%	+30%
Scaled Domestic Tariff(p/kWh)	2.10	2.70	3.30	3.90

3.8 In the above example, the secondary scaling factor varies between -30% and +30% and is a significant driver of the end tariff for customers. Implementing option 1 would mean that the secondary scaling factor would potentially have a large impact on the current charging methodology. The implication needs to be weighed up against the benefit of simplicity and transparency that this option would provide.

Option 2 – A Separate CDCM Model for Each Year of the Agreed Period

3.9 The alternative to using one model with one set of tariffs is to publish a different model for each year in the agreed period with a different set of inputs in each year.

3.10 The CDCM models for each year of the agreed period would be published at the start of the agreed period and no changes would be made to them following publication. This would allow for different CDCM inputs to be used within each year to ensure the charges retain greater cost reflectivity. For example, a DNO might decide to inflate the service model values by RPI across the agreed period or have a different volume forecast in each year.

3.11 A secondary scaling factor would be used to adjust the tariffs calculated in the published CDCM models to account for changes in volume forecasts and allowed revenue. An example is provided in the table below:

	Year	2015/16	2016/17	2017/18	2018/19
1	CDCM Model - Volume forecast (GWh)	20,000	21,000	22,000	23,000
2	CDCM model - Allowed Revenue forecast (£m)	450	460	480	500
3	CDCM model - Average p/kWh	2.25	2.19	2.18	2.17
4	Updated volume forecast for secondary scaling (GWh)	21,000	21,000	22,000	22,000
5	Updated Allowed Revenue forecast used in published CDCM model (£m)	460	460	490	500
6	Average p/kWh	2.19	2.19	2.23	2.27
7	Secondary Scaling Factor	-3%	0%	2%	5%

3.12 In the above table a CDCM model has been created in each year with a different volume forecast and allowed revenue forecast in each year. These assumptions mean that the base domestic tariff (in row 3) is different in each year. In this table, the volume forecast and allowed revenue forecast have been updated (in rows 5 and 6) and this is used to determine the secondary scaling factor that will be used in each year to ensure the DNO recovers their allowed revenue.

3.13 Option 2 is more complicated than option 1 as the DNO will need to publish a CDCM model for each year. However, the secondary scaling factors that are applied under this option are likely to be much smaller than those used under option 1 and therefore will not be a large driver of the tariffs.

3.14 To illustrate how the change proposal would work in practice a timeline has been produced below for a DNO fixing a tariff over a four year period.

Timeline to illustrate the options of DCP180 (for a four year agreed period)

Date	CDCM Model published to apply for the period below	Secondary scaling factor published & resultant tariffs published for the period below
Mar 2014	2015/2016 to 2018/2019	
Dec 2014		2015/16
Dec 2015		2016/17
Dec 2016	2019/2020 to 2022/2023	2017/18
Dec 2017		2018/19
Dec 2018		2019/20
Dec 2019		2020/21
Dec 2020	2023/2024 to 2026/2027	2021/22
Dec 2021		2022/23
Dec 2022		2023/24
Dec 2023		2024/25

3.15 The above table is based on the assumption that the CP is approved and implemented by December 2013. These dates would move forward by one year if the CP is not implemented by December 2013. For demonstration purposes, it is also assumed that the agreed period is four years.

3.16 There would be regular updates on what the secondary scaling factor might look like in the quarterly DCUSA Schedule 15 submission.

4 Working Group Assessment of DCP 180

4.1 The DCUSA Panel established a Working Group to assess DCP 180. The group consists of Distributor, Supplier, Consumer and Ofgem representatives. The various topics discussed by the Working Group are set out below.

Application of DCP 180

4.2 The Working Group noted that the CP applies only to CDCM tariffs, not EDCM tariffs. The proposer of DCP 180 explained that this is because there is a consultation being carried out by the Distribution Charging Methodologies

Forum (DCMF) Methodologies Issues Group (MIG) looking at measures to mitigate EDCM charging volatility². Raising a similar CP to DCP 180 for the EDCM will be considered once the outcome of this consultation is known.

Interaction with other DCUSA Change Proposals

- 4.3 The Working Group noted that DCP 180 is closely related to DCP 178, as both seek to reduce the impact of tariff volatility on Suppliers and consumers. Whilst DCP 180 looks to achieve this by reducing the frequency with which the CDCM is updated, DCP 178³ seeks to provide greater certainty of what DUoS tariffs will be by increasing the notice period for tariff changes from 40 days to 15 months.
- 4.4 Working Group members noted that that DCP 178 and DCP 180 are not mutually exclusive and could both be implemented to provide greater certainty which would help to keep prices down and facilitate competition.
- 4.5 The Working Group also noted that DCP 164 would require all CPs affecting tariffs which take effect from 1 April to have been approved by Ofgem by the end of September of the prior year. Should DCP 164 be approved it could impact on the implementation timescales for DCP 180.

The Agreed Lockdown Period

- 4.6 The group discussed the period that the CDCM model should be locked down for, i.e. whether it should be two, three, four or five years. It was noted that locking the model down for two years would not give consumers certainty over their budgets to the extent that locking it down for five years would, however some Working Group members felt that five years had too great an impact on the methodology and the cost reflectivity.
- 4.7 The Working Group noted that there will potentially be a greater step change under this proposal when the CDCM model is updated (every two to five years) than under the current method where the model is updated each year. This will

² The DCMF MIG EDCM consultation on measures to mitigate charging volatility within the EHV Distribution Charging Methodology is available here:

<http://www.energynetworks.org/electricity/regulation/structure-of-charges-edcm/consultation-files/6.-consultations.html>

³ DCP 178 - Notification period for change to use of system charges

create greater uncertainty for consumers and Suppliers at the point of the step change, however, step changes will occur less often and to mitigate this two years notice will be given. The balance between the tariff elements will become distorted and the step change may be significant when tariffs are rebalanced as a result of updating the CDCM model after a period of time.

- 4.8 It was noted that if the model is locked down for an agreed period, approved DCUSA Change Proposals could not be implemented over this period. This may mean that a consumer is exposed to less cost reflective tariffs over several years whilst waiting for an approved CP to be implemented.
- 4.9 To counter this it was suggested that approved CPs be implemented during the lock down period, which could result in a tariff change during the lock down period, however there was concern that this reduced the certainty that this change proposal was looking to provide to Suppliers and consumers.
- 4.10 As part of this consultation the Working Group is seeking industry views on what is an appropriate period of time to lock the model down for. Views are also sought on whether CPs accepted during the lock down period should be implemented either during the lock down period, or at the end of the period.

Impact on Cost Reflectivity and Cost Signals

- 4.11 The CDCM model is currently updated once a year, with new tariffs taking effect from 1 April each year. The proposer of DCP 180 notes that there is no reason why cost reflectivity should not be maintained over a longer period than one year.
- 4.12 The Working Group notes that Ofgem has indicated that it intends to implement licence changes to the electricity distribution sector for the start of RIIO-ED1 on 1 April 2015 in order to limit network charge changes to once per year on 1 April. Currently, it is possible for DNO's to update tariffs mid-year.

IDNO Discount Factors

- 4.13 A Working Group member raised a concern regarding the impact upon IDNO discount factors. The Working Group agreed that this CP could have a material impact upon a particular market sector should an agreed change proposal not

be implemented at the first possible opportunity. As part of this consultation the Working Group is seeking industry views on changes to the Methodology.

Scaling for Allowed Revenue

- 4.14 The Working Group agreed that from a visibility perspective it would be preferable for the allowed revenue scaling to occur within the CDCM model, as opposed to outside of it. This would avoid the complexity of applying the secondary scaling outside of the CDCM model.

5 Assessment against the DCUSA Objectives

- 5.1 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 Appendix B.
- 5.2 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 180.

General Objective 2 - The facilitation of effective competition in the generation and supply of electricity and (so far as is consistent therewith) the promotion of such competition in the sale, distribution and purchase of electricity

- 5.3 The CP better meets General Objective Two by reducing the volatility of DUoS charges which enables Suppliers to offer a greater range of products to consumers. Competition will also be more effective as consumers will be much less exposed to price changes caused by DUoS charge volatility.

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)

- 5.4 The CP better meets Charging Objective Two by ensuring niche or smaller Suppliers are not disadvantaged by unpredictable movements in use of system tariffs when providing fixed prices for consumers over contract durations larger than 12 months.

6 DCP 180 Implementation Date

- 6.1 The proposed implementation date for DCP 180 is 1 March 2014.

7 DCP 180 Legal Drafting

- 7.1 The proposed legal text for DCP 180 will be determined following the close of this consultation. A second consultation will be issued seeking views on this legal text.

8 DCP 180 – Consultation Questions

- 8.1 The Working Group is seeking views on the following consultation questions:

No.	Question
1	Do you understand the intent of the CP?
2	Are you supportive of the principles established by this proposal?
3	What benefits do you believe it will bring to your organisation?
4	Do you have any concerns about the change?
5	Are there any unintended consequences of this proposal?
6	Are there any alternative solutions or matters that should be considered? If yes, please provide details.
7	The Change Proposal suggests locking down the CDCM model for an agreed period which could be up to five years. Do you have a preference as to whether this should be two, three, four or five years? Please give your rationale.
8	Do you believe that the scaling factor should apply only to unit rates or all elements of tariffs? Please give your rationale.
9	It is proposed that IDNO discount factors would also be locked down for the same time period as the CDCM is locked down under this CP in line with other model inputs. Do you agree with this approach? Please give your rationale.
10	Should accepted Change Proposals accepted during the lock down period be implemented during the lock down period, or should they be implemented at the end of the period? Please provide your rationale.
11	Do you feel that this Change Proposal will have a significant impact on the cost reflectivity of Distribution Use of System Charges? If so, after how many years does this become an issue? Please give your rationale.
12	Do you have a preference between Option 1 and Option 2 (see section 3 above)? Please give your rationale.
13	Do you believe that secondary scaling (i.e. scaling to match allowed revenue and volume adjustments), should be included in the CDCM model or outside of it? Please give your rationale.
14	Do you consider that the proposal better facilitates the DCUSA objectives? Please give your rationale.
15	Do you have any views on the implementation date of this CP? Please give

	your rationale.
16	Do you have any further comments?

8.2 Responses should be submitted using Appendix A to dcusa@electralink.co.uk no later than **25 September 2013**.

8.3 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.

9 Next Steps

9.1 Responses to the Consultation will be reviewed by the DCP 180 Working Group. The group will use the responses received to aid it in its development of the legal text for the CP. A second consultation seeking views on the legal text will then be issued.

9.2 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.

Appendices

- Appendix A – Response Form
- Appendix B – DCP 180 CP Form