



## **DCUSA Second Consultation**

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### DCP 123 - Revenue Matching Methodology Change

## 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 is the second consultation issued to all DCUSA Parties and the Authority in accordance with Clause 11.14 of the DCUSA seeking industry views on DCP 123.
- 1.3 Parties are invited to submit comments using the form provided in Attachment A to [DCUSA@electralink.co.uk](mailto:DCUSA@electralink.co.uk) by **Wednesday, 2 April 2014**.

## 2 DCP 123 - REVENUE MATCHING METHODOLOGY CHANGE

- 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 Common Distribution Charging Methodologies (CDCM).
- 2.2 In the initial discussions for DCP 123 it was largely understood that revenue matching is achieved by a fixed adder approach applied, at the transmission exit level, in a manner which has the effect of impacting only the day/red unit prices, this view was included within the first consultation for DCP 123. However following further work with the model, it has been noted that revenue matching although achieved by a fixed added approach being applied at the transmission exit level has the effect of primarily impacting the day/red unit prices, with a small amount of revenue being picked up by the other unit rates (amber and green). By applying scaling primarily to peak time band consumption, 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 unallocated allowed income within the CDCM. As such, it has not been identified that these costs mainly 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.

### **3 CONSULTATION ONE**

- 3.1 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 B.
- 3.2 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).
- 3.3 Additional information on these proposed options and their relative benefits can be found in the first consultation document provided as Attachment B.

### **4 THE HYBRID SOLUTION**

- 4.1 Following consultation and further considerations, the Working Group developed a hybrid method of applying scaling which has the benefit of both of the options above, known as the "hybrid solution". The Working Group have chosen to proceed with this solution as it maintains the pre-scaled price signal for all tariff elements including fixed and capacity charges.
- 4.2 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.

- 4.3 Attachment C provides additional information on the hybrid solution calculation and a CDCM model which has been updated to implement this solution is provided as Attachment D. A description of the changes made to the CDCM to implement the DCP 123 hybrid solution is provided as Attachment E.
- 4.4 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 F and shows the impact on revenue and tariffs.

## **5 WORKING GROUP DISCUSSIONS**

- 5.1 The DCP 123 Working Group has reviewed the impact assessment and observes that in those distribution areas where there is negative scaling some of the unit rate tariffs have become zero under the DCP 123 solution.
- 5.2 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 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 p/kWh.
- 5.3 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 is 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. Also, if there is a floor price of 0.000 p/kWh this means that the pre-scaled differential between tariffs is not maintained which works against the principle that the group is seeking to achieve, i.e. to maintain the pre-scaled absolute differential between tariff elements. The Working Group can see benefits with both options and are consulting on which is the best option, i.e. allowing negative prices or having a floor price of 0.000p/kWh.
- 5.4 In the DCP 123 impact assessment at present London Power Networks (LPN) is the only affected DNO area due to the impact of negative scaling. However, the

Working Group noted that future CDCM changes (for instance, if asset replacement were to be included within the CDCM) and reductions in allowed revenue through RIIIO-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.

- 5.5 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.

## **6 ASSESSMENT AGAINST THE DCUSA OBJECTIVES**

- 6.1 The Working Group has identified that DCP 123 better facilitates DCUSA Charging Objective 3<sup>1</sup> by allocating unallocated allowed revenue across each of the different charging elements of the tariff rather than primarily into one time band and so ensuring that the unit costs in those peak time bands (day or Red unit rates) will better reflect the underlying cost message.

## **7 IMPLEMENTATION**

- 7.1 The proposed implementation date for DCP 123 is 1 April 2015.

## **8 PROPOSED LEGAL TEXT**

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

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<sup>1</sup> 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 CONSULTATION

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

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?
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)?

Please provide your rationale.

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?
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? Please provide your rationale.
5. Do you agreed with the proposed implementation date of 1 April 2015?
6. Do you believe that DCP 123 better facilitates the DCUSA General and Charging Objectives? Please provide your rationale.
7. Do you have any comments on the proposed legal text?
8. Are there any alternative solutions or matters that should be considered by the Working Group?
9. Do you have any further comments?

- 9.2 Responses should be submitted using Attachment A to [DCUSA@electralink.co.uk](mailto:DCUSA@electralink.co.uk) no later than **Wednesday, 2 April 2014**.
- 9.3 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.

## 10 NEXT STEPS

- 10.1 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.
- 10.2 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](mailto:DCUSA@electralink.co.uk) or telephone 020 7432 2842.

## 11 ATTACHMENTS

- Attachment A – Response form
- Attachment B – Consultation One
- Attachment C – Hybrid Solution Description
- Attachment D – DCP 132 Updated CDCM
- Attachment E – Description of CDCM Changes
- Attachment F - DCP 123 Impact Analysis
- Attachment G - DCP 123 Change Proposal
- Attachment H – Draft Legal Text