





| DCUSA Change Declaration | | At what stage is this document in the process? |
|--|---|--|
| <h1>DCP 266</h1> <h2>The calculation and application of IDNO discounts</h2> <p><i>Date Raised: 9 March 2016</i></p> <p><i>Raised as a: Standard Change</i></p> | | 01 – Change Proposal |
| | | 02 – Consultation |
| | | 03 – Change Report |
| | | 04 – Change Declaration |
| Purpose of Change Proposal: <p>DCP 266 Seeks to change the way in which Distribution Network Operator (DNO) tariffs to Licensed Distribution Network Operators (LDNOs) are calculated in the Common Distribution Charging Methodology (CDCM). Instead of calculating an LDNO percentage discount by comparing the avoided total cost (p/kWh) with the total cost (p/kWh) in the CDCM Price Control Disaggregation Model (PCDM), the intent of this change proposal is that the avoided total cost (p/kWh) calculated in the PCDM is compared with the average p/kWh figure for each All The Way (ATW) CDCM tariff in order to determine the LDNO % discount factor to be applied to each of the tariff components of the CDCM ATW tariff.</p> | | |
|  | <p>DCUSA Parties have voted on DCUSA Change Proposal (DCP) 266 with the outcome being a recommendation to the Authority on whether the Change Proposal (CP) should be accepted or rejected.</p> <p>The DCUSA Parties consolidated votes are provided as Attachment 1.</p> | |
|  | <p>For DCP 266, DCUSA Parties have voted and recommended to the Authority to determine that:</p> <ul style="list-style-type: none"> • the proposed variation (solution) should be rejected; and • the implementation date should be rejected | |
|  | <p>Impacted Parties: Distribution Network Operators (DNOs), Independent Distribution Network Operators (IDNOs) and Suppliers</p> | |
|  | <p>Impacted Clauses: Schedule 16: Introduction and paragraphs 3 and 52</p> <p>Schedule 17 and 18: paragraph 1.3</p> <p>Schedule 29: various paragraphs</p> | |

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Any questions?

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Timeline

The timetable for the progression of the CP is as follows:

Change Proposal timetable

| Activity | Date |
|---|------------------|
| Initial Assessment Report Approved by Panel | 09 March 2016 |
| First Consultation issued to Parties | 01 February 2018 |
| Second Consultation issued to Parties | 17 April 2019 |
| Change Report issued to Panel | 09 October 2019 |
| Change Report issued for Voting | 18 October 2019 |
| Party Voting Ends | 08 November 2019 |
| Change Declaration issued to Authority | 12 November 2019 |
| Authority Decision | 17 December 2019 |
| Implementation | 01 April 2023 |

1 Summary

What?

- 1.1 DCP 266 was raised by British Gas and seeks to change the way in which Distribution Network Operator (DNO) tariffs to Licensed Distribution Network Operators (LDNOs) are calculated in the Common Distribution Charging Methodology (CDCM).
- 1.2 The intent of this Change Proposal (CP) is to ensure that the revenue available to an LDNO once it has paid the host DNO's charges is entirely determined by the analysis of costs carried out in accordance with the requirements of DCUSA Schedule 29 'calculation of discount percentages for the purpose of determining certain LDNO use of system charges under schedules 16, 17 and 18', which are realised in the Price Control Disaggregation Model (PCDM).

Why?

- 1.3 It is the view of the Proposer that such an approach achieves a better allocation of revenues between an LDNO and the host DNO because it would be based on an allocation of total costs which will not be impacted by the hypothetical incremental cost allocation approach applied in the CDCM. The Proposer notes that this ensures an LDNO is able to receive the same margin as the host DNO's notional downstream business.

How?

- 1.4 The PCDM calculates percentage discounts which are applied to the CDCM all-the-way charges to allocate CDCM revenues between an LDNO and the host DNO. It does this by allocating allowed revenues on a p/kWh basis to different network tiers using specified drivers. The percentage discount is calculated as the sum of revenue allocated to network tiers for which the LDNO is responsible as a percentage of total revenue. These calculations are carried out by voltage level, resulting in inputs to the CDCM and Extra High Voltage Distribution Charging Methodology (EDCM) by voltage level, which are applied to tariffs by reference to the voltage of connection of the end user in question and the voltage of the LDNO to DNO boundary (for example a single percentage discount applies to all tariff elements of all end customers connected at LV where the DNO to LDNO boundary is at HV).
- 1.5 In order to maintain the existing process whereby the PCDM calculates a single percentage discount which can be applied to all tariff elements in the CDCM, the proposed solution is to calculate:
 - (a) the sum of revenue allocated to network tiers for which the LDNO is responsible (on a p/kWh basis using the principles of the existing PCDM); and
 - (b) an average absolute p/kWh for each all-the-way tariff in the CDCM, by dividing the total revenue collected from all tariff components of that tariff by the total volume associated with that tariff.

- 1.6 A discount percentage would then be calculated by dividing point (a) by point (b) above.
- 1.7 As a result of the inclusion of point (b) of paragraph 1.5 within the calculations, the PCDM will determine a percentage discount for each combination of all-the-way CDCM tariff and DNO to LDNO boundary voltage. As a result, an amendment to both the CDCM and EDCM models will be required to enable the models to use inputs by all-the-way tariff and DNO to LDNO boundary voltage.

2 Governance

Justification for Part 1 Matter

- 2.1 DCP 266 is classified as a Part 1 matter as it is likely to have a significant impact on competition in the distribution of electricity – see DCUSA clause 9.4.2 (B). This means that DCP 266 will go to the Authority for determination after the voting process has completed.

3 Why Change?

Background of DCP 266

The status quo:

- 3.1 The CDCM is an incremental cost methodology by design. It is intended to provide forward looking incremental cost signals to users of the network. LDNO percentage discounts are calculated in the PCDM and input to the CDCM to calculate the discounted CDCM tariffs to be applied to LDNOs.
- 3.2 The PCDM is a total cost methodology by design. By analysing the DNO's total costs and revenues, the PCDM is intended to determine the portion of the all-the-way revenue that an LDNO should retain once it has paid the host DNO's charges.
- 3.3 The Proposer considers that the two differing allocation methods are appropriate given their respective intentions, but that the way in which the LDNO discounts are calculated in the PCDM and applied within the CDCM could be improved to better reconcile the two approaches.
- 3.4 The calculation of LDNO discounts follows the following steps as indicated in paragraph 3 of Schedule 29:
 - a) Breakdown of price control allowed revenue between operating expenditure, depreciation and return on regulatory asset value.
 - b) Allocation of each of these components of price control allowed revenue to network levels.
 - c) Determination of a percentage allocation of total revenue per unit to network levels.

- d) Determination of the proportion of the LV mains deemed to be used by LV-connected embedded networks.
- e) Determination of the proportion of the HV network deemed to be provided by HV-connected embedded networks.
- f) Calculation of the discount percentage for each combination of boundary network level and end user network level.

3.5 The Proposer noted that DCP 266 is limited in scope to the final step (f) above. It seeks to change a perceived defect in the way the outputs of the prior steps are used to calculate the discount percentages that are applied to all-the-way tariffs in order to determine the LDNO tariffs.

Illustration of the defect:

3.6 The PCDM allocates total allowed revenues on a p/kWh basis to different network tiers using specified cost drivers. An illustrative example of the output of this is set out below (Table 1), which mirrors the information which can be found in tables 1439 and 1440 of the 2018/19 PCDM:

| | | p/kWh | Commentary |
|------------------------------|------------------------------------|-------|--|
| Total Revenue | | 2.50 | Total revenue divided by total units. |
| Allocation to Voltage Levels | Extra High Voltage (EHV) and above | 0.83 | Voltages above EHV are treated as one for the calculation of CDCM discounts - these are always host DNO assets. |
| | High Voltage (HV) | 0.50 | Allocation to each voltage, with LV Services treated as a separate voltage level to ensure revenues associated with LV Services are entirely allocated to the LDNO even when the DNO to LDNO boundary is at LV. |
| | HV/Low Voltage (LV) | 0.20 | |
| | LV Mains | 0.40 | Where the DNO to LDNO boundary is at HV or LV, the HV or LV allocation is apportioned between the DNO and LDNO based on a percentage 'HV Split' or 'LV Split' respectively, as detailed in steps d) and e) in paragraph 3.3. |
| | LV Services | 0.35 | |
| | Not to share | 0.22 | DNO incentive revenue and revenue relating to transmission exit charges are always allocated to the host DNO, and so are treated as 'upstream' revenue and not allocated to voltage levels. |

Table 1 - Illustrative PCDM Revenue Allocation to Voltage Levels

3.7 The CDCM calculates the incremental cost of each network tier and allocates these costs using load characteristics specific to each tariff. It also includes a revenue matching adjustment to ensure that the total allowed revenue is recovered. An illustrative example of the effective unit rates for a hypothetical LV tariff is set out below (Table 2), which mirrors the information which can be found in the 'M-ATW' worksheet of the 2018/19 CDCM model (albeit the CDCM model includes a breakdown between assets and operating costs):

| | | p/kWh | Commentary |
|------------------|---------------|-------|--|
| Total Charge | | 1.50 | Revenue per customer divided by forecast units per customer. Note that, if the CDCM and PCDM were on a consistent price basis, the p/kWh calculated by the incremental cost approach would be greater than the PCDM p/kWh revenue allocation for some customer groups and less than the PCDM p/kWh revenue allocation for others, ensuring that the DNO in aggregate recovers its total allowed revenue. |
| Incremental Cost | EHV and above | 0.48 | Contribution to assets and operating costs at each voltage, as determined by the incremental cost method in the CDCM |
| | HV | 0.22 | |
| | HV/LV | 0.08 | |
| | LV Mains | 0.10 | |
| | LV Services | 0.13 | |
| Scaler | | 0.49 | Revenue scaling to make up a shortfall (or correct an excess) between revenue derived from the incremental cost analysis and the DNO's revenue allowances |

Table 2 - Illustrative CDCM Incremental Cost Analysis

- 3.8 The current approach used to calculate LDNO discounts is to derive a percentage discount in the PCDM by taking the sum of revenue allocated to network tiers for which the LDNO is responsible, expressed on a p/kWh basis (LDNO revenue allocation), and dividing this by total revenue, also expressed on a p/kWh basis.
- 3.9 As a hypothetical example, using the figures from Table 1 above, with a DNO to LDNO boundary at LV and where the 'LV Split' apportionment is 100% to the LDNO and 0% to the DNO (i.e. where LDNOs are assumed to provide all of the LV network for users connected to their networks) the p/kWh revenue allocation to the LDNO would be given by the sum of the revenue allocation to voltage levels for which the LDNO is responsible, namely LV Services and LV Mains:

$$\begin{aligned} \text{LDNO Revenue Allocation p/kWh} &= \text{LV Mains p/kWh} + \text{LV Services p/kWh} \\ &= 0.40 \text{ p/kWh} + 0.35 \text{ p/kWh} = 0.75 \text{ p/kWh} \end{aligned}$$

- 3.10 Under the status quo, the LDNO discount for the provision of the LV network would then be given by this revenue allocation as a proportion of total revenue:

$$\text{Discount \%} = \frac{\text{LDNO Revenue Allocation p/kWh}}{\text{PCDM Total p/kWh}} = \frac{0.75 \text{ p/kWh}}{2.50 \text{ p/kWh}} = 30.0\%$$

- 3.11 This discount is then applied to the relevant all-the-way tariff in the CDCM, such that for the example LV tariff above (in Table 2) the effective p/kWh discount would be:

$$\begin{aligned} \text{Discount p/kWh} &= \text{Discount \%} \times \text{all the way tariff} = 30.0\% \times 1.50 \text{ p/kWh} \\ &= 0.45 \text{ p/kWh} \end{aligned}$$

- 3.12 It can be seen that the effective discount received by the LDNO is 0.30 p/kWh less than the appropriate LDNO revenue allocation derived in the PCDM for the provision of the relevant LV network (0.75 p/kWh vs 0.45 p/kWh). Obviously, different assumptions could be used to produce an outcome where the effective LDNO discount was higher than the LDNO revenue allocation derived in the PCDM – the important point is to illustrate that they will be different.
- 3.13 The proposer believes that the reason that the expected outcome does not materialise is because of a flawed mathematical logic being used to calculate LDNO tariffs. A discount percentage calculated using only the total cost and revenue approach in the PCDM subsequently applied to an incremental cost tariff calculated in the CDCM will not produce LDNO discounts which are reflective of a reasonable allocation of total costs of the elements of the DNO's business that are being undertaken by the LDNO unless, by pure chance, the p/kWh calculated by the incremental cost approach is identical to the PCDM p/kWh revenue allocation.
- 3.14 It is the view of the Proposer that it would be more appropriate to use the p/kWh LDNO revenue allocation derived in the PCDM and then convert this absolute p/kWh to a percentage discount based on the all-the-way CDCM tariffs, rather than based on the total revenue in the PCDM. Such an approach would ensure that the absolute p/kWh discount received by an LDNO remains aligned with the absolute p/kWh LDNO revenue allocation calculated in the PCDM and is not distorted by the incremental cost allocation approach applied in the CDCM.
- 3.15 In the example above, the proposed approach would derive the LDNO discount as follows:

$$\text{Discount \%} = \frac{\text{LDNO Revenue Allocation p/kWh}}{\text{CDCM all the way p/kWh}} = \frac{0.75 \text{ p/kWh}}{1.50 \text{ p/kWh}} = 50.0\%$$

- 3.16 This discount would then be applied to the relevant all-the-way tariff in the CDCM:

$$\begin{aligned} \text{Discount p/kWh} &= \text{Discount \%} \times \text{all the way tariff} = 50.0\% \times 1.50 \text{ p/kWh} \\ &= 0.75 \text{ p/kWh} \end{aligned}$$

- 3.17 It can be seen that the effective discount received by the LDNO is now aligned with the LDNO revenue allocation derived in the PCDM for the provision of the relevant LV network (0.75 p/kWh).

Limitations on the scope of DCP 266:

- 3.18 The PCDM uses 2007/08 data for the calculation of LDNO discounts whilst the CDCM uses input data for the charging year. So, without correction the LDNO revenue allocation (p/kWh) and the all-the-way CDCM cost (p/kWh) will be on different bases (e.g. the former will be in 2007/08 prices whilst the latter will be in nominal prices for the charging year). To resolve this, the LDNO revenue allocation calculated in the PCDM will be adjusted to account for allowed revenue and forecast volumes (kWh) for the relevant charging year (explained further in paragraph 4.5 onwards). Therefore, the scope of DCP 266 is limited to those inputs and does not include other various cost input values to the PCDM in order to correct how the LDNO revenue allocation is converted into a percentage discount.

4 Solution

DCP 266 Working Group Assessment

- 4.1 The DCUSA Panel established a Working Group to assess DCP 266. This Working Group consists of DNO, Supplier, IDNO 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.
- 4.2 The Working Group developed and issued two consultations, the first was issued on 01 February 2018 seeking industry opinion on the CP and views on the initial solution that had been proposed, which can be found in paragraphs 4.22 to 4.39 in the first consultation, see Attachment 3. There were thirteen respondents to the consultation, of which there was one Supplier, five DNOs, six IDNOs and one that chose to remain anonymous. Following the review of consultation responses, the Working Group agreed that the original solution required amendment. The Working Group's conclusions following the first consultation and the amended solution that followed are detailed in paragraphs 4.3 to 4.40 below. The full set of responses and the Working Group's comments are provided in Attachment 3.

Working Group Conclusions Following Consultation One

- 4.3 Following review of the consultation responses, the Working Group identified the key concerns to be addressed. A high-level overview of each of the areas is set out below, grouped into those which required a change to the initial solution; those where greater clarity has been provided; and those where consideration of the interaction of DCP 266 with other factors was required:

Changes to the proposed solution:

- Refine the initial solution to resolve the unintended consequences related to the updating of input data, including:
 - Changes to LDNO discounts which would arise from inconsistencies between inputs (see page 9);
 - Concerns related to volatility of LDNO margins as a result of DCP 266 (see page 11); and
 - Understanding the cause behind the increase seen in discounts being capped due to exceeding 100% (see page 13).
- Minimise the complexity of the methodology and modelling approach, and provide better justification where complexity is needed to support the solution (see page 14).

Provide additional clarity:

- Ensure greater clarity around the defect is provided to enable better understanding of what DCP 266 is seeking to achieve (see page 15);

- Clearly explain the approach taken regarding EHV Generation Credits is that of the status quo (see page 15); and
- Clarify the fact that the issue of '0' Volumes is an existing issue, not caused by DCP 266 and explain why the group developed a solution to the issue (see page 15).

Interactions with other factors:

- Monitor any potential for either Ofgem's Targeted Charging Review (TCR) Significant Code Review (SCR) or Electricity Network Access and Forward-Looking Charging Review SCR to interact with the work being undertaken by the group and provide further detail if/when needed (see page 16); and
- Understand how, if at all, DCP 266 interacts with competition law and address concerns related to the potential impact of DCP 266 on competition (see page 16).

4.4 Further detail on the work undertaken by the Working Group on each of the items is set out under subheadings below.

Changes to the Proposed Solution

Unintended Consequences of Input Data – Inconsistencies

- 4.5 Consultation respondents noted a number of internal inconsistencies within the PCDM which would be created by the changes made to input data as a result of the initial solution proposed for DCP 266 in the first consultation. Respondents highlighted that:
1. if only the proposed updates to inputs were made with no change to the calculation method, this would result in material reductions in the LDNO discounts;
 2. the proposed inputs result in a step change in the calculation of 'revenue not to share'; and
 3. the proposed inputs result in a step change in the reported allocation of units distributed.

Changes to underlying revenue allocation:

- 4.6 As stated in section 3, it is not the intent of the CP to review all data sources in PCDM. Hence point 1 above is of particular concern as any change in inputs which would change the discounts calculated under the existing methodology undermines the intent of the CP to only correct how the LDNO discount is calculated and applied. The Working Group agreed to further refine the initial solution for DCP 266 to resolve this issue.
- 4.7 The initial solution proposed in the first consultation used updated units and revenue data in order to ensure that the p/kWh LDNO revenue allocation calculated in the PCDM is on a consistent basis with the all-the-way p/kWh calculated in the CDCM. If this change were not made, the p/kWh calculated in the PCDM would be based on 2007/08 revenue data whilst the all-the-way p/kWh calculated in the CDCM would be based on charging year revenue data (i.e. 2019/20 for current tariffs); hence the percentage discount derived would be artificially low as it would not take into account the effects of (for example) inflation between 2007/08 and 2019/20.

- 4.8 However, the way in which the previous solution resolved this issue was to use charging year revenue and unit data for all calculations in the PCDM, including those used for the underlying allocation of revenue to voltage levels. For example, the calculation of 'revenue not to share' in the PCDM is based on 2007/08 revenue data in the existing PCDM, but the Working Group's initial solution proposed in the first consultation updated this to be based on charging year revenue data.
- 4.9 The Working Group's amended solution is designed to resolve the issue of cost data relating to Distribution Price Control Review 4/5 being used in conjunction with revenue and volumes data relating to the charging year whilst not changing any of the underlying PCDM revenue allocation calculations. The amended solution is to:
- (a) calculate the sum of revenue allocated to network tiers for which the LDNO is responsible, on a p/kWh basis using the existing PCDM (method and input data);
 - (b) uplift the value calculated in part (a) using a revenue scaler (to convert from being relative to 2007/08 revenue data to be relative to charging year revenue data) and a unit scaler (to convert from being relative to 2007/08 units to be relative to charging year units); and
 - (c) calculate an average absolute p/kWh for each tariff by dividing the total revenue collected from all tariff components of that all-the-way tariff by the total all-the-way volume associated with that tariff.
- 4.10 A discount percentage would then be calculated by dividing point (b) by point (c) above. As was the case with the initial solution, the PCDM will determine a percentage discount for each combination of all-the-way CDCM tariff and DNO to LDNO boundary voltage.
- 4.11 The legal text has been clarified to be explicit on when 2007/08 units and revenue data should be used and when charging year units and revenue data should be used.

Step change in the calculation of 'revenue not to share':

- 4.12 The impact analysis presented as part of the first consultation showed a step change in the calculation of 'revenue not to share'. This is caused by changes to DNO price control structures (introduced by RIIO-ED1) where a greater proportion of revenue is now recovered through incentive mechanisms; and by increases in transmission exit charges paid by DNOs. Further the allocation of RIIO-ED1 price control allowances between 'revenue to share' and 'revenue not to share' proposed by the Working Group in the previous consultation was challenged by a number of consultation respondents.
- 4.13 The amended solution resolves this issue by calculating 'revenue not to share' using the same input data as is currently used in the PCDM, with charging year data used for an additional step at the end of the process (as described in part (b) of the amended solution described in paragraph 4.09) and so the step change identified will no longer be observed.

Step change in units distributed:

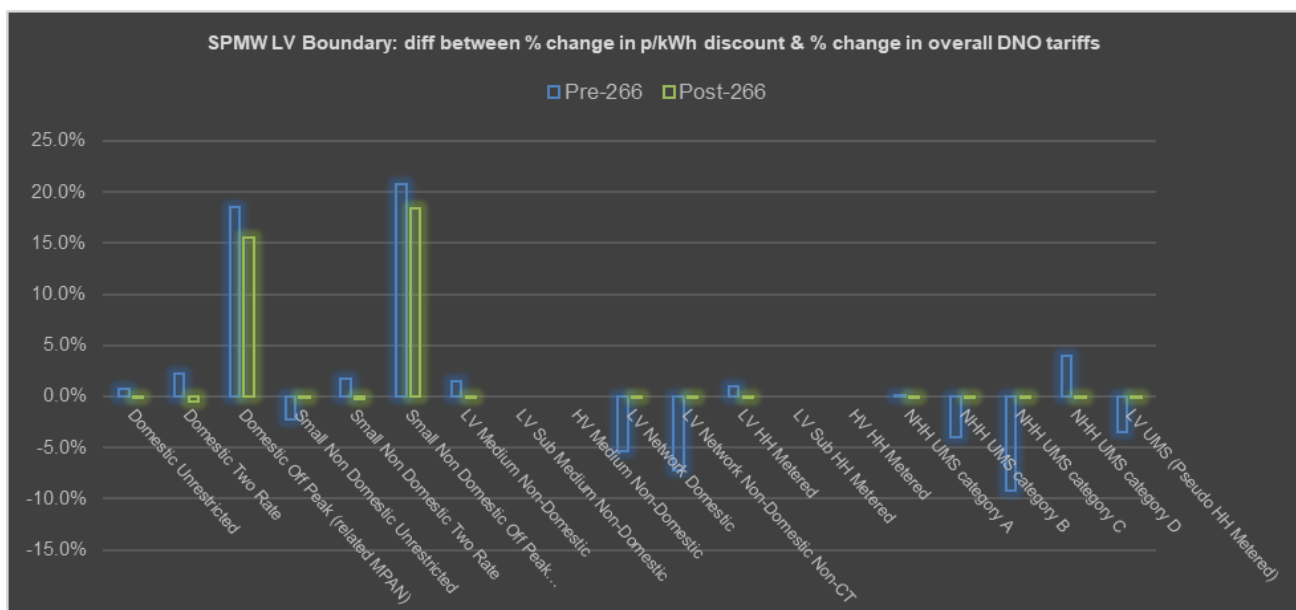
- 4.14 In the existing PCDM, 2007/08 units distributed data is input at three network levels – EHV, HV and LV. The solution proposed in the first consultation required these inputs to be updated to charging year data. Consultation respondents highlighted the inconsistency that arises if shifts in power flows through network levels are included without updating the allocation of costs or assets between those network levels.
- 4.15 The Working Group investigated the changes in the units distributed data between 2007/08 and the DNOs' latest forecasts and, in dialogue with the DNOs, confirmed that the units distributed data provided by DNOs for the first consultation allocated units distributed to customers connected at the HV Substation level to the EHV network level, in line with the current distribution licence definition of 'designated EHV'. However, the 2007/08 data pre-dates this definition of 'designated EHV', so units distributed to customers connected at HV Substation are allocated to the HV network level in the 2007/08 data. This has been rectified in the data being used for the modelling work undertaken for this consultation, ensuring consistency with the allocation of costs in the PCDM.
- 4.16 Further, the updated proposed solution uses units distributed data from 2007/08 to determine the allocation of revenue to network levels, with charging year data used for an additional step at the end of the process (as described in part (b) of the updated solution described in paragraph 4.09); hence the inconsistency identified between the allocation of costs and assets to voltage levels and the associated power flows no longer exists.

Unintended Consequences of Input Data – Volatility

- 4.17 A consultation respondent highlighted a concern that annual changes are likely to undermine their perception of the beneficial effect of the CDCM on competition.
- 4.18 The view of the Working Group is that the updated solution proposed would cause a decrease in the volatility of LDNO margins when expressed on a p/kWh basis other than potentially at the point of implementation, albeit volatility will increase when LDNO margins are expressed as a percentage of CDCM tariffs. This is because, under the proposed solution, the only CDCM inputs which would impact the p/kWh LDNO margins would be the units and allowed revenue forecast, used to derive the unit and revenue scaler described in part (b) of paragraph 4.09, whilst under the status quo the p/kWh LDNO margins are impacted by all CDCM inputs.
- 4.19 The Working Group agreed to test volatility of LDNO tariffs as a result of the changes made by DCP 266. To undertake this test, the Working Group requested the DCUSA modelling consultant to provide impact assessments using CDCM and PCDM model inputs from both the 2018/19 published models and 2019/20 published models.¹

¹ The only non-published input required for this was a breakdown of units distributed at EHV, HV and LV (as described in paragraph 4.16) for both years. This data was provided by DNOs for 2018/19 to enable the modelling work for the previous

4.20 To test the reduction in volatility brought about by DCP 266, the Working Group compared the change in p/kWh discounts between 2018/19 and 2019/20 with the overall all-the-way tariff change between these years. Under DCP 266 LDNO discounts should be protected from the volatility caused by updates to all CDCM inputs other than units and allowed revenue. By doing this it follows that the change in LDNO discounts should align more closely to the overall average all-the-way tariff change for the year. Attachment 4 contains the analysis undertaken by the Working Group, and the chart below shows the results for the SPMW region for LV boundary discounts. The chart shows that post DCP 266 there is more consistent change in LDNO discounts relative to the overall change in all-the-way tariffs.



4.21 Charts for all regions for LV and HV boundaries are contained in the attachment and show similar reductions in volatility. One way to summarise the reduction in volatility is to take the mean of the absolute variances by tariff for each DNO region of the change in LDNO discount compared to the overall DNO tariff change. The table below shows the results of this analysis:

proposed solution and was approximated for this modelling for 2019/20 in line with the percentage change in published volume forecasts.

| Mean Absolute Difference between discount change and overall ATW tariff change | | |
|--|---------|----------|
| | Pre-266 | Post-266 |
| ENWL | 2.2% | 0.8% |
| NPgN | 3.7% | 2.9% |
| NPgY | 2.9% | 1.0% |
| SSEH | 10.4% | 1.4% |
| SSES | 11.2% | 2.6% |
| SPD | 2.2% | 1.4% |
| SPMW | 4.7% | 1.8% |
| LPN | 12.2% | 2.5% |
| SPN | 6.8% | 2.7% |
| EPN | 4.7% | 2.5% |
| EMID | 2.9% | 0.7% |
| WMID | 3.7% | 0.6% |
| SWEST | 3.6% | 0.9% |
| SWALES | 2.3% | 0.5% |
| Overall | 5.3% | 1.7% |

- 4.22 It should be noted that whilst volatility can be demonstrated to reduce under DCP 266, it is not removed. LDNO discounts can still change materially year on year due to changes in DNO allowed revenues and assumptions on units distributed. For instance, between 2018/19 and 2019/20 the overall change tariffs in the SPMW region was 16.1%. The Working Group analysis set out in Attachment 4 shows that pre-DCP 266 the change in LV boundary LDNO discounts for SPMW would range between 6.9% - 20.1% (excluding off peak related MPAN tariffs), whilst post DCP 266 they would range between 15.6% - 16.0%.

Unintended Consequences of Input Data – Capped Discounts

- 4.23 The Working Group noted in the previous consultation that, in general, LDNOs shouldn't be paid to use the DNO's network (i.e. discounts should not exceed 100%), and so both the initial proposed solution presented in the first consultation and the amended solution maintain the existing principle that discounts are capped at 100%. The Working Group noted views of respondents regarding the possibility of the provision of services by LDNOs to DNOs in a future with dynamic networks with relation to discounts existing over 100%, but consider that introducing LDNO discounts in excess of 100% is beyond the scope of this CP.
- 4.24 Consultation respondents raised concerns over the increase in the number of tariff and DNO to LDNO boundary voltage combinations which resulted in LDNO discounts being capped at 100% when compared to the status quo of 81, with 923 instances identified (32.8%) under the initial solution proposed in consultation one. The amended solution results in 756 identified instances of LDNO discounts being capped at 100% which is 26.9% of tariffs.

- 4.25 Of particular interest to the Working Group was the number of LDNO customers impacted by capped discounts under each solution. In total across all DNO areas there are 621,014 customers connected to LDNO networks. As can be seen in the table below, there is a large decrease in the numbers of customers being impacted by the tariffs being capped at 100% under both the original and updated solutions.

| | Status Quo | Initial Solution | Amended Solution |
|---|------------|------------------|------------------|
| Number of LDNO customers Impacted | 3,156 | 146 | 243 |
| Percentage of LDNO customers Impacted | 0.508% | 0.024% | 0.039% |
| Number of DNO areas where capping impacts customers | 1 | 3 | 4 |

Complexity of the solution

- 4.26 Consultation respondents highlighted concerns around the complexity of the initial solution for DCP 266. The Working Group noted that the legal text changes required to implement the change are in fact relatively simple, with the complexity arising as a result of a circularity created between the PCDM and CDCM model. The diagram below is a visual representation of the circularity created between the PCDM and CDCM model.



- 4.27 The circularity arises because the all-the-way CDCM tariffs vary depending on the level of LDNO discount percentages – if LDNO discount percentages increase, the revenue derived from LDNO tariffs decreases, and so in order to target allowed revenue more revenue is recovered through scaling in the CDCM. The revenue allocated to LDNOs in the PCDM in p/kWh is not impacted by this circularity, but the discount percentages are determined based on the revenue allocated divided by the average all-the-way CDCM p/kWh which causes the circularity. The circularity occurs because the LDNO discount percentages calculated in the PCDM vary depending on the average p/kWh of the all-the-way tariff calculated in the CDCM, but the all-the-way tariffs themselves vary depending on the level of LDNO discounts.
- 4.28 Since the previous consultation, the Working Group has refined the solution, which does not remove this circularity but does reduce its impact, by carrying out the full calculation of the p/kWh allocation of revenue to network tiers based entirely on 2007/08 data and then scaling to charging year data. The DCUSA Panel has also appointed a new modelling consultant and so have taken the opportunity for a different approach to the implementation of the amended solution. The updated modelling does not attempt to resolve the circularity but leaves this task to the DNOs to undertake when populating the models.

Providing Additional Clarity

The Defect

- 4.29 The Working Group noted that responses to the consultation indicated that the defect that DCP 266 is seeking to amend had not been defined clearly enough, with some respondents stating that they did not agree with the view that a defect exists.
- 4.30 The Working Group updated the rationale for stating that a defect exists throughout sections one and three of the Change Report (and thus within this Change Declaration) and also updated the example initially provided which outlined the approach to calculating LDNO discounts.

EHV Generation Credits

- 4.31 The Working Group noted that the issues raised in response to the consultation question on the same related topic of generation credits are out of scope of this CP. It was clarified that the intent of this CP is not to amend the way the generation credits are determined but to change the way they are applied when determining LDNO discounts (i.e. from a percentage discount to a p/kWh approach, consistent with the intent of the CP for demand charges).

Zero Volumes

- 4.32 The Working Group noted that the issue around zero volumes is an existing issue in the CDCM, whereby if a volume forecast of zero units is entered for some tariffs, the resulting tariffs may not be cost-reflective for any customer subsequently utilising that tariff.

- 4.33 The solution for DCP 266 requires a non-zero kWh volume forecast for every all-the-way tariff in order to calculate an average p/kWh for that tariff (part (c) of the proposed solution detailed in paragraph 4.09). The amended solution to this issue has been refined to stipulate (in the legal text of Schedule 16) that DNOs will need to include a forecast non-zero number of customers and associated volumes for all customer groups.

Interactions with other factors

TCR SCR and Electricity Network Access and Forward-Looking Charging Review SCR Interaction

- 4.34 The Working Group's comments related to this area are contained in section 6 below.

Competition

- 4.35 During its review of responses to the first consultation the Working Group noted respondents' concerns around the implications to competition as a result of DCP 266. The Working Group was specifically interested in how DCP 266 interacts, if at all, with competition law and questioned, in general, to what revenues a party which is providing substitute services in place of a dominant party should be entitled.
- 4.36 The Working Group discussed two interpretations:
1. The party providing the substitute service should be entitled to the same level of revenue which the dominant party derives in respect of the service which is being substituted; or
 2. The party providing the substitute service should be entitled to the level of revenue which the dominant party would derive in respect of the service which is being substituted if the dominant party's business were notionally split into an element which provides the service being substituted and an element providing the remainder.
- 4.37 In the context of a DNO being the dominant party and an LDNO substituting the provision of services at (for example) low voltage, the two interpretations result in the following:
1. The LDNO should be entitled to the revenue which the DNO derives in respect of the provision of services at low voltage. Such revenue is determined by the CDCM which generates forward looking cost signals and so does not necessarily reflect the cost incurred in providing the service to each group of users; rather it generates cost signals to incentivise user behaviours which can reduce the long-run costs of operating the DNO's network, with the DNO's total costs and return recovered in aggregate across all user groups through 'revenue matching' or 'scaling'; or
 2. The LDNO should be entitled to the revenue which the DNO would derive from providing low voltage services if the DNO's business were notionally split into a portion providing higher voltage services and a portion providing lower voltage services. In order to approximate the revenues which the notional entity providing low voltage services would derive, it may be reasonable to assume that such a notional entity would be subject to a similar price control mechanism as the DNO is itself, and so such revenues would be

determined based on an analysis of the costs and required return of providing low voltage services.

4.38 The solution for DCP 266 aligns to the second of these interpretations.

DCP 266 Solution

4.39 As detailed in paragraphs 4.09 and 4.10, the amended solution is to:

- (a) calculate the sum of revenue allocated to network tiers for which the LDNO is responsible, on a p/kWh basis using the existing PCDM (method and input data);
- (b) uplift the value calculated in part (a) using a revenue scaler (to convert from being relative to 2007/08 revenue data to be relative to charging year revenue data) and a unit scaler (to convert from being relative to 2007/08 units to be relative to charging year units);
- (c) calculate an average absolute p/kWh for each tariff by dividing the total revenue collected from all tariff components of that all-the-way tariff by the total all-the-way volume associated with that tariff; and
- (d) determine a discount percentage by dividing the result of part (b) by the result of part (c) for each tariff.

4.40 As was the case with the initial solution, the PCDM will determine a percentage discount for each combination of all-the-way CDCM tariff and DNO to LDNO boundary voltage. As a result, an amendment to both the CDCM and EDCM models will be required to enable the models to use inputs by all-the-way tariff and DNO to LDNO boundary voltage.

Working Group Conclusions Following Consultation Two

4.41 The Working Group developed and issued a second consultation on 17 April 2019 seeking industry views on the amended solution set out above, which had been simplified, both in terms the explanation of the solution but also the background information contained within. There were ten respondents to the consultation, of which there was one Supplier, four DNOs, four IDNOs and one that chose to remain anonymous. A summary of the responses received, and the Working Group's conclusions are set out below. The full set of responses and the Working Group's comments are provided in Attachment 5.

Question 1 - Do you agree with the proposer's view that there is a defect in the logic in the way that discounts are calculated and applied to determine LDNO tariffs?

- 4.42 The Working Group noted that out of the ten respondents, three agreed and seven disagreed with the Proposer's view that there is a defect in the logic in the way that discounts are calculated and applied to determine LDNO tariffs. For the majority of those that disagreed with the view of the Proposer, they also questioned whether the solution results in a fair or unfair allocation of costs as compared to the status quo.
- 4.43 One respondent who did not agree with the Proposer's view, explained that the PDCM & CDCM methodologies are different and were designed and approved as being calculated on different bases by Ofgem. The Working Group noted that it recognises that they (the CDCM and PCDM) are different and highlighted in their comments that what DCP 266 attempts to do is reconcile the two different approaches.
- 4.44 Further to these points, a number of respondents highlighted their view that the 'perceived defect' has yet to be explained in sufficient detail nor has enough justification been given for altering the status quo.

Question 2 – Do you have any comments on the two interpretations set out under paragraph 4.37?

- 4.45 The Working Group noted that out of the ten respondents, four were of generally supportive of the second interpretation with one concluding both were acceptable. Of the remaining six, five respondents voiced concerns around the implications to competition as a result of DCP 266, whilst the remaining respondent didn't have any comments.
- 4.46 The Working Group commented that their consideration of revenue entitlements was a conceptual aid used following its review of responses to the first consultation, where respondents' voiced concerns around the implications to competition as a result of DCP 266. The Working Group clarified that it does not have any control over LDNO revenues as these are governed/controlled by Ofgem.
- 4.47 An extensive discussion around the potential implications of DCP 266 with respect to competition law was had by the Working Group, following which it was agreed that it would be beneficial to seek legal opinion on if there are any implications of DCP 266 with respect to competition law. Following the request to the DCUSA legal advisors, two options were presented as means of assisting the Working Group. The optionality became a necessity following their initial scope which would be both expensive but also take some time to complete. This item was discussed during the Panel meeting held on 19 June 2019, following which the full documentation was issued and a request for a decision on which option the Panel considered appropriate was confirmed. The Panel agreed that the second option should be taken which is at a lower cost to Parties and should be of assistance to the Working Group.

4.48 The approach for the second option was based on arguments presented within the request for legal opinion and primarily focussed upon the concept of a "margin squeeze" as an abuse of dominance under UK and/or EU competition law. It was suggested that this may enable the DCP 266 Working Group to engage with this issue in the context of the consideration of the CP, and proposed that the following be prepared:

- an overview of the relevant legal tests that have been applied by UK and EU courts in recent cases to assess the circumstances in which a "margin squeeze" will constitute an abuse of dominance under UK and/or EU competition law **(the "Legal Assessment")**; and
- their preliminary assessment of any aspects in relation to which the concept of a "margin squeeze" could raise potential issues under UK and/or EU competition law in the context of the CP, with this preliminary assessment prepared in reliance upon the arguments in response set out within the Legal Opinion Request **(the "Preliminary Risk Assessment")**.

4.49 The document provided by the DCUSA legal advisors to the Working Group acts as attachment 6 to the Change Report (and thus within this Change Declaration) and an overview of the contents of the document and the subsequent discussions and impact on the progression of DCP 266 is provided in paragraphs 4.60 to 6.65 below.

Question 3 – Do you have any comments on the proposed solution and do you believe it addresses the defect identified?

Are there any alternative solutions that should be considered?

4.50 The Working Group noted that the majority of respondents reiterated similar points made in response to question 1 which were:

- that they disagreed with the view of the Proposer that there is a defect and questioned whether the solution results in a fair or unfair allocation of costs as compared to the status quo; and
- provided their view that the 'perceived defect' has yet to be explained in sufficient detail nor has enough justification been given for altering the status quo.

4.51 In addition to the comments reiterated within earlier questions, some respondents had included comments that were relevant to the solution set out in the first consultation, being the increase in the number of LDNO tariffs capped at 100%, the exclusion of some incentive revenues, the updating of a select few data sources and not all data sources and the potential interaction with the two charging related SCRs initiated by Ofgem. With respect to these items, the Working Group made the following comments:

- The Working Group pointed out that paragraphs 4.24 to 4.26 of the second consultation document shows that there is a large decrease in the numbers of customers being impacted by the tariffs being capped at 100% under both the initial and amended solutions.

- The Working Group disagreed with the comment “certain percentage of total revenues have been excluded based purely on the choice of wording “, as it was a feature of the initial solution proposed in the first consultation and related to what was classed as an incentive or not. This was explained in paragraphs 4.13 and 4.14 of the second consultation document.
- Respondents again raised concerns around the fact that DCP 266 is limited in its scope with respect to only updating certain input data and that the updating of the entire data set is out of scope of this. The Working Group noted that, this limitation was set out in the both the first and second consultation documents, but this doesn’t nor has it ever precluded any other Party raising a CP if necessary once the SCRs have been finalised.
- With respect to the concerns raised around interactions with Ofgem initiatives, the Working Group note that all information related to this CP will be provided to Ofgem by 13 August 2019 and this is likely to be before any decisions made on the SCRs and could be accounted for in that process.

Question 4 – Do you consider that the proposal better facilitates the DCUSA Charging Objectives?

- If so, please detail which Charging Objectives are better facilitated by DCP 266 and provide your rationale.
- If not, please detail which Charging Objectives are not better facilitated by DCP 266 and provide your rationale.

4.52 At a high level, the following table sets out the views of each respondent, with respect to whether or not the CP better facilitates any of the DCUSA Charging Objectives.

| Respondent | Charging Objective 1 | Charging Objective 2 | Charging Objective 3 | Charging Objective 4 | Charging Objective 5 | Charging Objective 6 |
|-----------------|----------------------|----------------------|----------------------|----------------------|----------------------|----------------------|
| 1. | N/A | Positive | N/A | N/A | N/A | N/A |
| 2. | N/A | Negative | Negative | N/A | N/A | N/A |
| 3. | N/A | Negative | Negative | Negative | N/A | Negative |
| 4. | N/A | Negative | Negative | Negative | N/A | Negative |
| 5. | N/A | Negative | N/A | N/A | N/A | N/A |
| 6. | N/A | Positive | Positive | N/A | N/A | N/A |
| 7. | N/A | Positive | N/A | N/A | N/A | N/A |
| 8. ² | Negative | Negative | Negative | Negative | Neutral | Negative |
| 9. ³ | - | - | - | - | - | - |
| 10. | N/A | Negative | N/A | N/A | N/A | N/A |

² This respondent referred to their response to the same question from the first consultation and so those responses have been used to populate this row.

³ This respondent stated that they “do not believe the charging objectives are better facilitated” but did specify which.

- 4.53 The Working Group note that the responses related to the whether or not Parties believe that DCP 266 better facilitates the DCUSA Charging Objectives are set out in more detail in section 5 below.

Question 5 – If DCP 266 were to be approved are you supportive of the proposed implementation date of 01 April 2021?

- 4.54 The Working Group noted that a variety of responses were received, some in support of the proposed implementation date of 01 April 2021 and others suggesting deferring until the completion of the SCR and/or 01 April 2023. Given this, the Chair put the question of an agreed implementation date to a Working Group vote. The result of which was that four members were supportive of 01 April 2023 and three members were supportive of 01 April 2021. The Working Group therefore proposed the implementation date to be 01 April 2023.

Question 6 – Do you have any comments on the proposed legal text for DCP 266?

- 4.55 The Working Group noted that there were no comments or suggestions with respect to the proposed legal text for DCP 266.

Question 7 – Do you have any other comments on DCP 266?

- 4.56 The Working Group noted that two respondents had further comments on DCP 266, the first of which questioned the rationale for proposing such a change to the CDCM when it *“was agreed and implemented as an ‘incremental cost methodology by design’*”, as well as why the Proposer, who would be unaffected by such a change would raise it in the first place.
- 4.57 The Working Group highlighted that the discussion around the calculation and application of IDNO discounts started some way in the past during meetings of Distribution Charging Methodologies Forum Methodologies Issues Group from 23 November 2012 to January 2016. Further to this it was noted that the Proposer agreed to sponsor the raising of DCP 266 to provide a level of impartiality.
- 4.58 The other respondent’s further comments centred around whether it is appropriate that DCP 266 should be progressing in parallel with the SCR and noted that in their view *“working group engagement by many members has been largely passive, with active engagement provided by a limited subset of the working group”*.
- 4.59 The Working Group acknowledged the resource issues that are felt across the industry with the ongoing multiple workstreams and although there may have been less active engagement during the development of DCP 266 by some Working Group members, an increased level of engagement has been seen via the number of respondents to both consultations and upon reviewing the responses to the consultations.

Legal advice and its impact on the progression of DCP 266

4.60 Following receipt of the legal advice with respect to DCP 266 and any potential competition law implications, a Working Group meeting was held on 12 August 2019, to review the document provided by the DCUSA legal advisors. The bullet points below provide a summary of the key messages that were conveyed by the legal advisors:

- The advice is high level and does not conclude one way or another whether DCP 266 would lead to abusive margin squeeze;
- DCP 266 is in an area where there will be an impact on margins and the advice therefore recognises that there is a risk that it could create abusive margin squeeze;
- Therefore, the advice considered that it would be prudent to carry out further analysis in the form of an As Efficient Competitor (AEC) test to confirm as far as possible that this would not be the case.

4.61 It should be noted that during the Working Group meeting held on 12 August 2019, one Working Group member explained their belief that a case of margin squeeze exists as a result of the solution developed for DCP 266 and therefore, they could not continue to develop DCP 266 and confirmed that with immediate effect, they were resigning from the Working Group. Subsequent to that meeting, two other Working Group members resigned, citing that their decision to do so was based on maintaining compliance with their company's internal competition policy and procedures related to margin squeeze and competition law.

4.62 Feedback was also received from Ofgem, to inform their thinking on the advice provided to the group, which was that Ofgem would find the AEC type analysis referred to useful in its assessment of the CP. Ofgem questioned whether the Working Group or the DNOs were able to do this, and if not, then it was suggested that rationale be provided as to why the group felt this was the case. The Working Group were unsure as to whether undertaking an AEC test was within their remit and questioned if they could request for each DNO to carry one out.

4.63 Given the Working Group's uncertainty on the topic, it was agreed for the Secretariat to raise this as an item during the next DCUSA Panel meeting to seek guidance from the Panel as to any further engagement with the DCUSA legal advisors. The item was raised during the DCUSA Panel meeting held on 21 August 2019, with the Panel agreeing that in order to understand how best to proceed, a discussion between the DCUSA legal advisors, the Chair and Secretariat of the DCP 266 Working Group and a Panel member should be arranged.

4.64 A meeting was held on Wednesday, 11 September 2019, during which the following questions were discussed:

- Whether the Working Group should continue or not, after giving consideration to:
 - the competition law guidance document; and
 - the potential quoracy issues due to the resignation of members due to competition law concerns?

- If the Working Group can continue:
 - Does the Working Group have the right to request an AEC from Parties;
 - can this be only done by DNOs; and
 - if so, and if Parties decline to undertake such a request, where does this leave us?
- Whether the following option would be viable:
 - To close down the meetings and the Secretariat finish the Change Report suggesting that Parties consider the competition act when voting, defer to Party responses with respect to whether or not DCP 266 better facilitates the DCUSA Objectives (instead of providing the Working Groups view) and highlight the potential for Ofgem to seek further information directly from the DNOs?

4.65 The result of the meeting with the DCUSA legal advisors is as follows:

- The Working Group, nor the Panel can compel the DNOs to undertake a robust AEC test (the test indicated as necessary in the legal advice) without detailed access to information that would be considered commercially and competitively sensitive.
- So, it is only the DNOs themselves that could individually undertake such a test and therefore it was suggested that either, the DNOs undertake an AEC test during the voting period to assist in their decision to either accept or reject to the change or potentially prepare for a request to supply the relevant information to Ofgem, if they were to decide to carry out the test themselves.
- Therefore, it was agreed that the best course of action was to close down the Working Group, meaning that no further meetings were held and for the Secretariat to include a summary of the legal advice received and a suggestion will be included that Parties consider the competition act when voting and Party responses with respect to whether or not DCP 266 better facilitates the DCUSA Objectives will be used instead of providing the Working Groups view.

Relevant Objectives

Assessment Against the DCUSA Objectives

4.66 For a DCUSA Change Proposal to be approved it must be demonstrated that it better meets the DCUSA Objectives. There are five DCUSA General Objectives and six DCUSA Charging Objectives. This Change Proposal impacts the DCUSA Charging Objectives, as set out in the table below, however, it should be noted that the full list of objectives is documented in the CP form provided as Attachment 7.

| DCUSA Charging Objectives | | Identified impact |
|---------------------------|---|--|
| 1 | that compliance by each DNO Party with the Charging Methodologies facilitates the discharge by the DNO Party of the obligations imposed on it under the Act and by its Distribution Licence | Majority of respondents believe there is no impact on this 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) | Majority of respondents believe there is a negative impact on this 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 | Majority of respondents believe there is a negative impact on this objective |
| 4 | that, so far as is consistent with Clauses 3.2.1 to 3.2.3, the Charging Methodologies, so far as is reasonably practicable, properly take account of developments in each DNO Party's Distribution Business | Majority of respondents believe there is no impact on this objective |
| 5 | that compliance by each DNO Party with the Charging Methodologies facilitates compliance with the Regulation on Cross-Border Exchange in Electricity and any relevant legally binding decisions of the European Commission and/or the Agency for the Co-operation of Energy Regulators. | Majority of respondents believe there is no impact on this objective |
| 6 | that compliance with the Charging Methodologies promotes efficiency in its own implementation and administration. | Majority of respondents believe there is no impact on this objective |

4.67 When this change was proposed, both the General and Charging Objectives were to be considered when assessing whether the change would better facilitate the Objectives. Since the implementation of DCP 275 'Code Governance Review 3 & SLC 22' which introduced a final Charging Objective that aligned both sets of Objectives, any CP which changes the charging methodologies needs only be assessed against the Charging Objectives. Therefore, only the DCUSA Charging Objectives should be considered when assessing the impact of DCP 266.

The Proposers View

4.68 The Proposer believes that DCUSA Charging Objective 2 will be better facilitated by reducing or removing the current distortion in the absolute level of total avoided cost discount received by LDNOs by ensuring that the absolute total cost discount calculated in the PCDM is not affected by the CDCM for all-the-way tariffs or changes to it. The Proposer believes that there is currently a logical defect in the approach to calculating and applying LDNO discounts which results in LDNO charges which do not reflect *“a reasonable allocation of total costs to the elements of the DNOs business that are being undertaken by the IDNO”*. DCP 266 removes this defect and by ensuring that the p/kWh discounts received by LDNOs remains aligned with the absolute level of avoided costs calculated in the PCDM, this change will promote competition in the distribution of electricity. The Proposer believes the absolute level of discount (p/kWh) received by LDNOs is also likely to be more stable and predictable since it will be protected from the impact of any changes to the methodology for all-the-way CDCM tariffs, which will also promote competition in the distribution of electricity.

Party Views

- 4.69 Following the development of the amended solution and as a result of the responses to the second consultation, and the subsequent legal advice with respect to the potential competition law implications for DCP 266 the views provided by Parties in their responses to the consultation have been used instead of providing the Working Groups view.
- 4.70 In assessing whether DCP 266 better facilitates the DCUSA Charging Objectives, respondents provided a variety of views across a number all of the DCUSA Charging Objectives, however Charging Objectives two and three were given the most consideration. Given this, the Secretariat provides a cross section of views across those objectives and notes that full set of responses provided are contained in Attachment 5.

DCUSA Charging Objective Two

Positive

- Yes, objective two would be better facilitated by aligning the LDNO discount received to the LDNO revenue allocation for the relevant network level.
- There will also be a reduction in the volatility of the LDNO discounts on a p/kwh basis by aligning the discounts more closely to the all-the-way tariff, and limiting the CDCM inputs influencing the discounts to only the unit and allowed revenue forecast, thus facilitating competition.

Negative

- The Second Consultation states that *“The Proposer believes that DCUSA Charging Objective 2 will be better facilitated”*⁴ for the following reasons:
 - *“by reducing or removing the current distortion in the absolute level of total avoided cost discount received by LDNOs”.*
- We agree that removal of a distortion could better facilitate competition. But the nature of the alleged defect / distortion has not been articulated since the issue was first raised in 2016. The Second Consultation describes the operation of the current CDCM and the impact of DCP 266, but at no point has the proposer stated why it considers the current approach does not result in a reasonable allocation of total cost - contrary to Ofgem’s and the DNOs’ decision that it does. It would be unreasonable for the Working Group to conclude that DCUSA Charging Objective 2 is better facilitated by removal of a defect that: (a) has not been shown to exist; (b) if it does exist, has not been shown to have a distortionary effect on competition.
 - *“by ensuring that the p/kWh discounts received by LDNOs remains aligned with the absolute level of avoided costs calculated in the PCDM, this change will promote competition in the distribution of electricity”.*
- No reason is given as to why this change would promote competition per se; we therefore assume that this relates back to the removal of the alleged defect. Again, it would be unreasonable for the Working Group to conclude that DCUSA Charging Objective 2 is better facilitated by removal of a defect that: (a) has not been shown to exist; (b) if it does exist, has not been shown to have a distortionary effect on competition. If this does not relate back to removal of the alleged defect, some explanation needs to be provided as to why this change, by itself, would promote competition.
 - *“The Proposer believes the absolute level of discount (p/kWh) received by LDNOs [under DCP 266] is also likely to be more stable and predictable since it will be protected from the impact of any changes to the methodology for all-the-way CDCM tariffs, which will also promote competition in the distribution of electricity”.*
- This suggests that the one benefit that does not rely on the existence of a defect is merely *“likely”*. We do not consider that a *“likely”* increase in stability and predictability is sufficient to justify the Proposer’s claim that DCP 266 will promote competition.

⁴ References to the DCUSA Charging Objectives are references to the Applicable Charging Methodology Objectives in SLC 22A (Part B) of the electricity distribution licence.

DCUSA Charging Objective Three

Positive

- There will also be a reduction in the volatility of the LDNO discounts on a p/kwh basis by aligning the discounts more closely to the all-the-way tariff, and limiting the CDCM inputs influencing the discounts to only the unit and allowed revenue forecast, thus facilitating competition.

Negative

- The choice of data sources within DCP266 is inconsistent as certain items are derived from older sources. This difference may create unintentional skewing as each dataset reflects the time period it relates to and the associated technological, societal, and socioeconomic factors. Although the current methodology utilises an outdated dataset it is consistent in that method and hence these factors are normalised within the values.
- DCP266 would drastically increase the circumstance in which the discount percentage 100% cap is applied by a factor of approximately 20.

5 Impacts & Other Considerations

Significant Code Review Impacts

TCR SCR Interaction

- 5.1 The Working Group noted that currently DCP 266 does not impact on the TCR SCR as there is no element of residual charges in scope of DCP 266. It is noted that a 'minded to' consultation by Ofgem on the TCR was released on 28 November 2018 and closed on 04 February 2019. In June 2019, Ofgem consulted on further matters, including updated analysis on the Capacity Market and system costs, and the findings of the Balancing Services Charges Task Force. Ofgem has subsequently issued a further consultation on a refined 'minded to' approach to residual charging banding in the TCR.

Electricity Network Access and Forward-Looking Charging Review SCR Interaction

- 5.2 Following Ofgem's consultation issued on 23 July 2018, it was noted that on 18 December 2018 Ofgem published its decision to launch an SCR entitled 'Electricity Network Access and Forward-looking Charging Review'. The documentation with that decision included the scope and form of the review.
- 5.3 The Working Group noted that during the January 2019 Distribution Charging Methodologies Development Group meeting, members discussed all in-flight charging methodology CPs to determine their interaction with this SCR and whether any steps should be taken in their development. The Proposer noted that DCP 266 would break the link between the all-the-way tariff and the LDNO discounts and therefore, by continuing to progress the CP, there is an opportunity to realise some indirect benefits. It is the Proposer's view that if the CP needs to be withdrawn then the work would need to be considered under the SCR.

5.4 Following the second consultation, it has been explained that in the document issued by Ofgem on their decision to launch a SCR for Access and Forward Looking Charges, Ofgem set out that this would include a review the distribution connection boundary, although this would be contingent on being able to send better locational signals through DUoS charges. It is expected that consideration of this aspect will form part of a second working paper due by the end of 2019. The first of two working papers related to the Access and Forward-Looking Charges SCR was published on 6 September 2019, which contained:

- options for reform of access rights for distribution and transmission;
- options for improving locational accuracy of distribution charges; and
- charge design options for distribution and transmission charges:

5.5 It is expected that a short piece of work will be undertaken to look at the impacts on IDNO charging. However, both outputs (on IDNO impacts and the distribution connection boundary) would be after the point in time that a decision on DCP 266 would have been expected to be provided.

Model Impacts

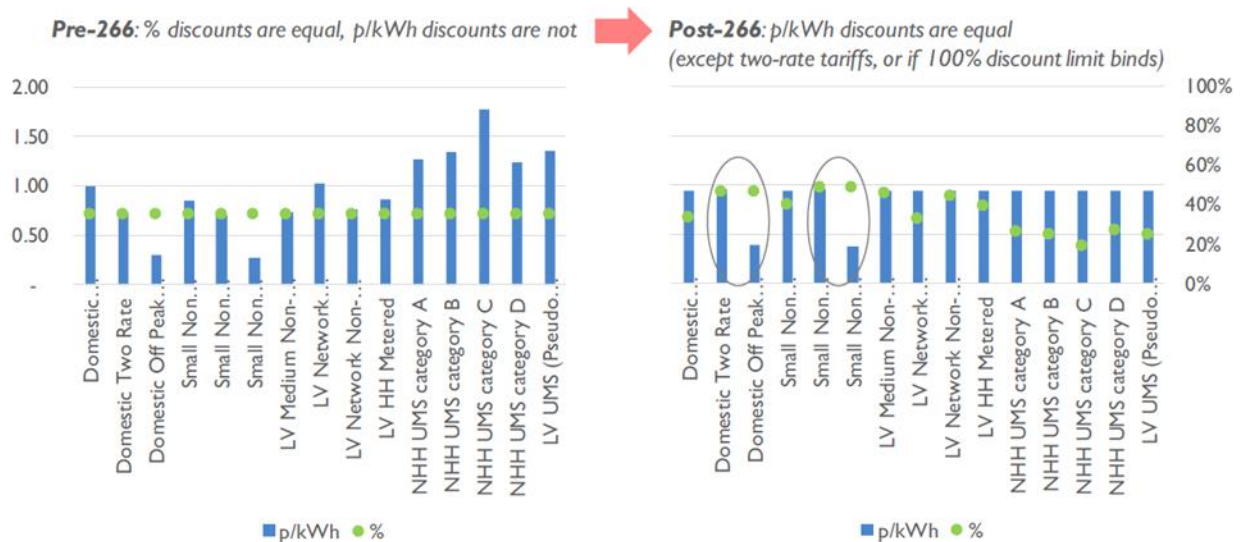
5.6 The Working Group considered that this change would benefit from Parties being able to understand its impact in modified models with impact estimates. The DCP 266 modelling documentation acts as Attachment 8. The CDCM model, EDCM model and PCDM have been modified to incorporate the proposed solution.

5.7 An amended Annual Review Pack (ARP) would usually also be needed due to the close linkage with the CDCM, however the as the Working Group have agreed to an implementation date of 01 April 2023, they have also agreed that amending the ARP that far in advance will serve no real purpose given the other work being carried out by industry that potentially will coincide with the implementation of DCP 266.

5.8 DNO Working Group members have successfully populated the DCP 266 models and replicated the expected resulting outputs.

Impact Assessment

5.9 Following the modelling work, the Working Group requested for CEPA/TNEI, as the DCUSA modelling consultants, to undertake an impact assessment. Attachment 9 contains the results of the impact assessment, including a document that details the overall effect of DCP 266. In the commentary document, it was noted that DCP 266 causes discounts to diverge in percentage terms, but to converge to the same p/kWh value for the same boundary level.



5.10 The graphs above illustrate the basic effect for one DNO (ENWL) for one boundary level (LV). Whereas before DCP 266, percentage discounts were consistent across tariffs – leading to inconsistent discounts per kWh, after DCP 266 each tariff receives a different % discount – leading to a consistent discount per kWh.

5.11 The following table summarises the impact of DCP 266 on core all-the-way tariffs. The complete dataset by licensee and including all tariffs can be found at attachment 9 ('CDCM per kWh' tab of the 2018/19 Impact Assessment spreadsheet).

| % Change in Average p/kWh for all-the-way tariffs | GB Min | GB Average | GB Max |
|---|----------|------------|--------|
| Domestic Unrestricted | (0.04%) | 0.02% | 0.08% |
| Small Non Domestic Unrestricted | (0.03%) | 0.02% | 0.09% |
| LV HH Metered | (0.03%) | 0.03% | 0.21% |
| HV HH Metered | (0.01%) | 0.02% | 0.10% |
| LV UMS (pseudo HH Metered) | (0.03%) | 0.01% | 0.09% |

5.12 The impact of DCP 266 on LDNO discounts differs by tariff, by DNO-LDNO boundary level, and by DNO area. For most tariffs, in most DNO areas, and at most boundary levels, DCP 266 would raise percentage discounts. But for some high-volume tariffs, notably 'Domestic Unrestricted', DCP 266 would lower discounts in most cases.

5.13 Taking all DNO areas together, these impact assessments suggest that DCP 266 would increase LDNO margins at CDCM boundary levels⁵ by £897,568 (+2.29%) in 2018/19, and £800,125 (+1.55%) in 2019/20. The impact for individual LDNOs will differ according to the profile of their customer bases. The aggregate impact for 2018/19 is summarised in the table below (note the £0.1m change in overall revenue is simply a result of tariff rounding rather than an underlying change in revenue allowances):

| DNO Revenue (£m) From... | Pre-DCP 266 | Post-DCP 266 | Change |
|------------------------------------|-------------|--------------|--------|
| DNO customers | 5,352.7 | 5,353.7 | 1.0 |
| LDNO customers with boundary at LV | 13.6 | 13.7 | 0.1 |
| LDNO customers with boundary at HV | 29.3 | 28.3 | (1.0) |
| All Customers | 5,395.6 | 5,395.7 | 0.1 |

5.14 The following tables show the impact of DCP 266 on the LDNO margin expressed as a percentage of the host DNO ATW charge in respect of the above five tariffs for DNO/LDNO boundary at LV and HV respectively. The complete dataset by licensee and including all tariffs can be found at attachment 9 ('% Discount' tab of the 2018/19 Impact Assessment spreadsheet).

| Change to LDNO margin as a percentage of the host DNO all-the-way charge at LV boundary | GB Min | GB Average | GB Max |
|---|----------|------------|--------|
| Domestic Unrestricted | (6.0%) | (1.9%) | 1.0% |
| Small Non Domestic Unrestricted | (0.8%) | 5.6% | 13.4% |
| LV HH Metered | 0.2% | 4.0% | 9.4% |
| HV HH Metered | | | |
| LV UMS (Pseudo HH Metered) | (10.9%) | 0.8% | 17.9% |

| Change to LDNO margin as a percentage of the host DNO all-the-way charge at HV boundary | GB Min | GB Average | GB Max |
|---|----------|------------|---------|
| Domestic Unrestricted | (9.6%) | (3.3%) | 1.6% |
| Small Non Domestic Unrestricted | (1.4%) | 9.4% | 23.2% |
| LV HH Metered | 0.3% | 6.8% | 15.0% |
| HV HH Metered | (12.5%) | (5.1%) | (0.4%) |
| LV UMS (Pseudo HH Metered) | (17.6%) | 1.2% | 28.4% |

⁵ i.e. Not including discounts applied within the EDCM model, for which input data was not available to the modelling team.

Discounts applied in the CDCM model account for 98% of LDNO customers.

5.15 The following table sets out a summary of the impact that DCP 266 has on Domestic Unrestricted tariffs at different boundary levels. It provides a summary of 2018/19 charges before and after the application of DCP 266, alongside the impact of DCP 266 in absolute terms and as a percentage of the equivalent margin before the application of DCP 266. Charges are calculated on the Domestic Unrestricted tariff using an annual consumption figure of 3,100kW/h.

| | 2018/19 charges excluding DCP 266 | | | 2018/19 charges including DCP 266 | | | Net impact of DCP 266 | | | | | |
|------------------------|-----------------------------------|-------------|--------|-----------------------------------|-------------|--------|-----------------------|----------|------------|----------|------------|----------|
| | DNO ATW (£/annum) | IDNO Margin | | DNO ATW (£/annum) | IDNO Margin | | ATW charge | | IDNO LV:LV | | IDNO HV:LV | |
| | | LV:LV | HV:LV | | LV:LV | HV:LV | £/annum | % change | £/annum | % change | £/annum | % change |
| Electricity North West | £80.14 | £28.63 | £46.10 | £80.14 | £26.76 | £43.09 | £0.00 | 0.00% | -£1.87 | -6.52% | -£3.01 | -6.53% |
| NPG Northeast | £87.61 | £34.86 | £55.83 | £87.61 | £32.52 | £52.11 | £0.00 | 0.00% | -£2.34 | -6.71% | -£3.72 | -6.67% |
| NPG Yorkshire | £74.57 | £29.25 | £46.51 | £74.63 | £29.51 | £46.93 | £0.06 | 0.08% | £0.26 | 0.89% | £0.42 | 0.90% |
| SSEN SEPD | £75.67 | £25.80 | £43.66 | £75.71 | £24.54 | £41.48 | £0.04 | 0.05% | -£1.26 | -4.89% | -£2.18 | -5.00% |
| SSEN SHEPD | £126.07 | £36.22 | £75.40 | £126.07 | £32.66 | £67.92 | £0.00 | 0.00% | -£3.56 | -9.83% | -£7.48 | -9.92% |
| UKPN EPN | £77.38 | £23.86 | £38.23 | £77.35 | £19.19 | £30.77 | -£0.03 | -0.04% | -£4.67 | -19.57% | -£7.45 | -19.50% |
| UKPN LPN | £65.58 | £17.67 | £30.48 | £65.62 | £16.44 | £28.39 | £0.03 | 0.05% | -£1.22 | -6.92% | -£2.09 | -6.85% |
| UKPN SPN | £83.67 | £26.17 | £43.53 | £83.67 | £22.75 | £37.91 | £0.00 | 0.00% | -£3.42 | -13.05% | -£5.62 | -12.90% |
| WPD East Midlands | £72.46 | £21.83 | £34.86 | £72.46 | £21.39 | £34.16 | £0.00 | 0.00% | -£0.45 | -2.04% | -£0.70 | -2.00% |
| WPD South Wales | £101.27 | £33.08 | £64.51 | £101.34 | £32.83 | £64.03 | £0.07 | 0.07% | -£0.25 | -0.77% | -£0.48 | -0.74% |
| WPD South West | £102.48 | £38.20 | £63.42 | £102.48 | £36.99 | £61.38 | £0.00 | 0.00% | -£1.21 | -3.17% | -£2.04 | -3.22% |
| WPD West Midlands | £81.89 | £27.28 | £42.02 | £81.96 | £28.14 | £43.36 | £0.07 | 0.08% | £0.86 | 3.17% | £1.34 | 3.19% |
| SPEN SPM | £101.37 | £38.13 | £60.77 | £101.34 | £35.38 | £56.41 | -£0.03 | -0.03% | -£2.75 | -7.22% | -£4.36 | -7.18% |
| SPEN SPD | £93.22 | £36.07 | £60.89 | £93.22 | £33.83 | £57.15 | £0.00 | 0.00% | -£2.24 | -6.20% | -£3.74 | -6.14% |

5.16 Attachment 10 contains the backing data which has been used to build this summary table.

Environmental Impacts

- 5.17 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 266 were implemented. The Working Group did not identify any material impact on greenhouse gas emissions from the implementation of this CP.

Engagement with the Authority

- 5.18 Ofgem has been engaged throughout the development of DCP 266 as an observer of the Working Group.

6 Implementation

- 6.1 As detailed on paragraph 4.54 above, a variety of responses were received to this consultation question, some in support of the proposed implementation date of 01 April 2021 and others suggesting deferring until the completion of the SCR and/or 01 April 2023. Given this, the Chair put the question of an agreed implementation date to a Working Group vote. The result of which was that four members were supportive of 01 April 2023 and three members were supportive of 01 April 2021. The Working Group therefore proposed the implementation date to be 01 April 2023.

7 Legal Text

- 7.1 The proposed DCP 266 legal text has been provided as Attachment 2, which the Working Group has drafted with support from the DCUSA modelling consultants and has been reviewed by the DCUSA legal advisors. The Proposer is satisfied that the legal text meets the intent of the solution.
- 7.2 DCP 266 amends various paragraphs in Schedule 29, which changes the calculation of an LDNO percentage discount so that the LDNO revenue allocation (p/kWh) calculated in the PCDM relative to 2007/08 units and revenue data is uplifted to be relative to charging year units and revenue data and is then compared with the average p/kWh figure for each all-the-way CDCM tariff in order to determine the LDNO percentage discount factor to be applied to each of the tariff components of the CDCM all-the-way tariff.
- 7.3 As described in paragraph 6.7 and 6.8, there is a need to also update the models for the CDCM and EDCM which in turn, necessitates amendments to the introductory paragraphs of each of the applicable Schedules, being 16, 17 and 18. The proposed legal text captures the necessary amendments to each Schedule with respect to the model version number and date at which the methodology is effective.

8 Code Specific Matters

Reference Documents

8.1 Not applicable

9 Voting

9.1 The DCP 266 Change Report was issued to DCUSA Parties for voting on 18 October 2019.

Part 1 Matter: Authority Decision Required

DCP 266: Proposed Variation (Solution)

9.2 In accordance with Clause 13.5, for Parties to have been deemed to recommend to the Authority that the change solution be Accepted there needs to be a majority of Party Categories whose votes to accept, when summed together, equate to more than 50% of the total votes of Parties or Groups within in each category.

9.3 In the case where only two Party Categories vote on a Change Proposal, and one Category votes to accept and the other votes to reject, there can be no such majority and therefore, in accordance with Clause 13.5, the Parties have been deemed to recommend to the Authority that the change solution be Rejected.

DCP 266: Implementation Date

9.4 In accordance with Clause 13.5, for Parties to have been deemed to recommend to the Authority that the implementation date be Accepted there needs to be a majority of Party Categories whose votes to accept, when summed together, equate to more than 50% of the total votes of Parties or Groups within in each category.

9.5 In the case where only two Party Categories vote on a Change Proposal, and one Category votes to accept and the other votes to reject, there can be no such majority and therefore, in accordance with Clause 13.5, the Parties have been deemed to recommend to the Authority that the implementation date be Rejected.

The table below sets out the outcome of the votes that were received in respect of the DCP 266 Change Report that was issued on 18 October 2019 for a period of 15 working days.

| DCP 266 | WEIGHTED VOTING | | | | |
|---------------------|-----------------|--------|-----------------------|-----------------------------|---------------------------|
| | DNO | IDNO | SUPPLIER ⁶ | CVA REGISTRANT ⁷ | GAS SUPPLIER ⁸ |
| CHANGE SOLUTION | ACCEPT | REJECT | N/A | N/A | N/A |
| IMPLEMENTATION DATE | ACCEPT | REJECT | N/A | N/A | N/A |

10 Recommendations

DCUSA Parties Recommendation

10.1 DCUSA Parties have voted on DCP 266 and in accordance with Clause 13.5 of the DCUSA, recommend to the Authority to determine that the Change Proposal be rejected and thus that the proposed variation to the DCUSA should not be made.

11 Attachments

- Attachment 1 – DCP 266 Consolidated Party Votes
- Attachment 2 – DCP 266 Legal Text
- Attachment 3 – DCP 266 Consultation One & Collated Responses
- Attachment 4 – DCP 266 Volatility Test Analysis
- Attachment 5 – DCP 266 Consultation Two & Collated Responses
- Attachment 6 – DCP 266 Response to Request for Legal Advice
- Attachment 7 – DCP 266 Change Proposal Form
- Attachment 8 – DCP 266 Modelling Documentation
- Attachment 9 – DCP 266 Impact Assessment Documentation
- Attachment 10 – DCP 266 Data Set for Domestic Unrestricted Summary Table

⁶ No votes were cast in this Party Category

⁷ This Party Category was not eligible to vote on this CP

⁸ This Party Category was not eligible to vote on this CP