

DCP 423 'LDNO DISCOUNTS FOR NEGATIVE SCALING'

COLLATED CONSULTATION RESPONSES WITH WORKING GROUP COMMENTS

Company	Confidential/ Anonymous	1. Do you understand the intent of the Change Proposal?	Working Group Comments
UKPN	Non-Confidential	Yes	
BU-UK	Non-Confidential	Yes	
UK Power Distribution	Non-Confidential	Yes	
Northern Powergrid	Non-confidential	Yes	
IDCSL	Non-confidential	Yes	
SPEN	Non-confidential	Yes	
Indigo Networks	Non-confidential	Yes	
ENWL	Non-confidential	Yes	
Scottish and Southern	Non-confidential	Yes, although we have questions and concerns regarding the recovery of any shortfall and who would ultimately pay for this. Due to further	

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Electricity Networks		clarification required, we have not responded to the below questions at this time.	
Working Group Conclusions:			

Company	Confidential/ Anonymous	2. Are you supportive of the principles that support this Change Proposal?	Working Group Comments
UKPN	Non-Confidential	Yes	
BU-UK	Non-Confidential	Yes	
UK Power Distribution	Non-Confidential	Yes	
Northern Powergrid	Non-confidential	Yes	
IDCSL	Non-confidential	Yes	
SPEN	Non-confidential	Yes	

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Indigo Networks	Non-confidential	Yes	
ENWL	Non-confidential	Yes, we are broadly supportive of the principles, although we do not believe that considerations such as the margin available to industry parties are directly relevant. However, we do agree that the change may be justified based on improving cost reflectivity, and ensuring there is no restriction, distortion or prevention of competition in the distribution of electricity. In terms of competition, as-efficient competitor analysis is likely to be the most effective method for assessing if a change better facilitates the objectives.	
Scottish and Southern Electricity Networks	Non-confidential	No comment	
Working Group Conclusions:			

Company	Confidential/ Anonymous	3. Do you know of any rationale as to why there is a negative margin for a tariff component?.	Working Group Comments
UKPN	Non-Confidential	No	
BU-UK	Non-Confidential	No, we believe that this is an unintended consequence of the way that the targeted charging review outcomes interacted with LDNO charges and is not intentional. We can see no rationale as to why a negative margin would be introduced.	

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UK Power Distribution	Non-Confidential	Not being what is described here	
Northern Powergrid	Non-confidential	No	
IDCSL	Non-confidential	No, not that the Working Group hasn't already identified.	
SPEN	Non-confidential	No, other than has been raised in the this DCP.	
Indigo Networks	Non-confidential	No	
ENWL	Non-confidential	<p>Taking the term 'negative margin' to refer to a situation where an IDNO tariff is greater than the equivalent DNO tariff, we know possible rationales that might justify such a situation.</p> <p>For example where a universal discount percentage is applied to a range of tariff components, or a portfolio of IDNO customers, it may result in a correct outcome overall even if it seems to create an anomaly for an individual tariff component or end customer tariff. We do not know if such a rationale is applicable to this specific instance, or if such a rationale would be justified in terms of the charging objectives. However, such a rationale might be particularly applicable in a situation where the residual is largely removed from one tariff component, and a single IDNO discount percentage is applied to all tariff components.</p> <p>Where negative scaling is applied, this may be the result of an over-collection of revenue in a prior year. A possible rationale for negative</p>	

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		<p>margin may be that the prior year provided 'excess' margin due to unreasonably high tariffs. Again, it is unclear if this rationale is applicable in this specific case, or if it should even be part of assessment of this proposal against the charging objectives. It is our view that this rationale is not likely to be relevant in this case.</p> <p>However, in general, the available margin should reflect the costs incurred by an as-efficient competitor. In this case, the as-efficient competitor test (AEC) would test a pricing scheme by testing the all-the-way tariff (t) against the IDNO tariff (i) and the AEC 'downstream' costs (c). This test would be $t - i \geq c$. As c is unlikely to be negative for a demand customer, in general we would expect there to be an available positive margin to an IDNO network. However, as it is difficult to disaggregate 'c' across tariff components it may not be correct to apply this analysis to individual tariff components.</p>	
Scottish and Southern Electricity Networks	Non-confidential	No comment	
Working Group Conclusions:			

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Company	Confidential/ Anonymous	4. Do you have any examples of the issue explained happening? If so, what was the impact? Are there any other scenarios where this issue could occur that have not been captured within the Consultation document?	Working Group Comments
UKPN	Non-Confidential	We are not aware of any scenario not detailed in the consultation.	
BU-UK	Non-Confidential	We have no examples beyond the given example in the consultation document.	
UK Power Distribution	Non-Confidential	No comment	
Northern Powergrid	Non-confidential	No, other than the occurrence already highlighted by the Working Group.	
IDCSL	Non-confidential	IDCSL noted the higher LDNO tariffs compared to the All The Way tariffs for the same tariff in the LPN area (standing charges) for April 2023. We have not reviewed other DNO areas and were not impacted by this discrepancy directly as we are a new market entrant and were not active in the market until April 2024. We are not aware of other scenarios where the same issue could occur.	
SPEN	Non-confidential	No	
Indigo Networks	Non-confidential	No	

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ENWL	Non-confidential	This issue has not occurred in our network area.	
Scottish and Southern Electricity Networks	Non-confidential	No comment	
Working Group Conclusions:			

Company	Confidential/ Anonymous	5. Do you agree with the solution proposed or is there an alternative solution that could be considered?	Working Group Comments
UKPN	Non-Confidential	<p>We are broadly comfortable with the solution proposed, however although modelled on what was proposed for DCP328 this change was rejected by the Authority and so this is not an approach which parties have seen in their charges to date.</p> <p>An alternative approach would be calculate the discount factors / tariffs as proposed, and to add a final adder at the end of any calculation of charges, which using the example used by the WG would apply the 0.13% (which was c£500k) across the group of customers where the floor has impacted their charge. This would only be a minor change to any customers charge (likely to impact ATW customers) but would look to recover the correct revenue from the specific group of customers impacted rather than spreading it across all. We are uncomfortable if this was only addressed within the reiteration process, as this would result in being recovered from all</p>	

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		customers rather than a specific group, which would include EDCM customers, who were certainly not originally allocated these costs.	
BU-UK	Non-Confidential	We agree with the solution proposed and do not have any alternative.	
UK Power Distribution	Non-Confidential	Yes I agree with the solution proposed.	
Northern Powergrid	Non-confidential	Yes, we agree with the solution proposed. It is both practical and proportional to the issue identified.	
IDCSL	Non-confidential	Yes, we agree that a floor should be applied to the application of LDNO discounts.	
SPEN	Non-confidential	Yes, agree with proposed solution.	
Indigo Networks	Non-confidential	Yes	
ENWL	Non-confidential	<p>No, we are not convinced the proposed solution addresses the root cause of the issue.</p> <p>Furthermore, we believe it may introduce new distortions to competition in distribution as it seeks to address others. If we take the limiting case of $t = i + c$ then introducing a fixed cost adder for an upstream cost (a) would result</p>	

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	<p>in $t + a = i + a + c$. The expected impact of an adder for an upstream cost would be that the available margin to an IDNO would be unchanged. It is not clear that this occurs under the proposed solution, because it would allow an IDNO to increase their tariff and margin without reflecting the elements of the tariff that are in place before the application of the fixed adder, and as such it may introduce a distortion to competition.</p> <p>An alternative solution may be to change the floor applied to fixed charges in the event of a negative residual.</p> <p>In more detail, the CDCM can be considered to calculate the tariffs as follows: The all-the-way tariff (ATW) can be considered to be comprised of three elements: a forward looking charge (FLC), a residual (R), and fixed adder (FA) for items such as SoLR. The IDNO tariff (IT) can be considered to be equal to this but adjusted by a discount percentage (d) to account for the notional downstream costs now incurred by the IDNO party. However, as the fixed adders apply only to DNO incurred 'upstream' costs these should not be subject to the discount percentage. Hence:</p> $ATW = FLC + R + FA$ $IT = ((FLC + R) * d) + FA$ <p>And the available IDNO margin is therefore $(1 - d) * (FLC + R)$</p> <p>Considering the fixed tariff element in isolation, in the case of an ATW tariff with a positive FA but a total ATW value of 0, the available margin would be expected to be negative. This is because the negative residual causes R to tend towards the zero floor value: $R = - (FA + FLC)$.</p> <p>This is undesirable, but the most logical solution would seem to be to floor the total ATW fixed tariffs not at zero in the case of a high negative residual, but at the value of the forward looking charge excluding fixed adders</p>	
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		<p>instead. In this case, $R = -FLC$, and although zero margin would be available on the fixed charge element other tariff components would provide a positive IDNO margin.</p> <p>Applying this to the example of LDN 23/24, the residual would be capped at -3.31p/MPAN/day and not at -3.52 as before (i.e. it would be capped at -FLC, excluding the FA element). This would result in fixed charges for both all-the-way, and LV/HV IDNO fixed charges, of 0.21p/MPAN/day. Unit rates are lowered to ensure correct overall recovery of revenue.</p> <p>This solution can be crudely modelled in the LDN 23/24 CDCM by changing cell J225 on the "Revenue matching" sheet from $=MAX(-J223,J199)$ to $=MAX(-J223,J199)+J48$. This avoids negative IDNO margin and preserves the fixed adder differential between tariffs.</p> <p>This solution aims to achieve three goals: to preserve the IDNO margin at a value equal to the conceptual value $(1 - d) * (FLC + R)$ for the fixed tariff component, to avoid a negative IDNO margin, and to preserve revenue recovery (scaling).</p>	
Scottish and Southern Electricity Networks	Non-confidential	No comment	
Working Group Conclusions:			

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Company	Confidential/ Anonymous	6. Do you agree with the Working Groups approach to follow the same process as DCP 328 and not correct the shortfall fall in revenues? If not, please provide an alternative method.	Working Group Comments
UKPN	Non-Confidential	We have reservations with using the approach proposed for DCP328 as this change was rejected by the Authority, we have proposed an alternative as part of our response to Q5.	
BU-UK	Non-Confidential	Yes	
UK Power Distribution	Non-Confidential	Yes, as mechanisms exist to pick up the balance	
Northern Powergrid	Non-confidential	Yes. The shortfall will be dealt with by the CDCM/EDCM/PCDM iteration process.	
IDCSL	Non-confidential	Yes	
SPEN	Non-confidential	Yes, agree with DCP 328 process.	
Indigo Networks	Non-confidential	Yes	

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ENWL	Non-confidential	<p>No, we believe the charging methodologies should seek to ensure that the allowed revenue target is collected in full.</p> <p>Shortfall or excess recovery of allowed revenues, tested against the price control formula and not model calculations, can result in DNO penalties and should be avoided.</p> <p>DCP328 was rejected by all categories of industry party and the Authority, and hence we do not consider it to have set any precedent for such an approach.</p> <p>Scaling should be adjusted to ensure tariffs recover the revenue target. If necessary this could be done by introducing a secondary round of scaling limited in scope to specific tariff components. Ideally the existing scaling calculation could be adjusted.</p>	
Scottish and Southern Electricity Networks	Non-confidential	No comment	
Working Group Conclusions:			

Company	Confidential/ Anonymous	7. Do you have any comments on the modelling that has been conducted for DCP 423?	Working Group Comments
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UKPN	Non-Confidential	No, we are comfortable with the work undertaken for the solution proposed.	
BU-UK	Non-Confidential	No	
UK Power Distribution	Non-Confidential	No	
Northern Powergrid	Non-confidential	No	
IDCSL	Non-confidential	No	
SPEN	Non-confidential	None	
Indigo Networks	Non-confidential	No	
ENWL	Non-confidential	The modelling indicates that for the 23/24 tariffs in LDN area there is no longer any difference between the all-the-way tariff and the LDNO tariffs. However, an ideal solution should consider each underlying element of the final tariff charge. Under the modelled solution the IDNO margin does not reflect the forward looking and residual elements of the all-the-way tariff.	

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		We believe this may indicate a potential distorting impact of the proposed solution.	
Scottish and Southern Electricity Networks	Non-confidential	No comment	
Working Group Conclusions:			

Company	Confidential/ Anonymous	8. Do you have any comments on the draft legal text?	Working Group Comments
UKPN	Non-Confidential	No, we believe that the legal text is appropriate for the solution proposed.	
BU-UK	Non-Confidential	None	
UK Power Distribution	Non-Confidential	No	
Northern Powergrid	Non-confidential	No	

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IDCSL	Non-confidential	No	
SPEN	Non-confidential	None	
Indigo Networks	Non-confidential	No	
ENWL	Non-confidential	None	
Scottish and Southern Electricity Networks	Non-confidential	No comment	
Working Group Conclusions:			

Company	Confidential/ Anonymous	9. Do you consider the solution better facilitates the DCUSA objectives? Please give supporting reasons?	Working Group Comments
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UKPN	Non-Confidential	<p>We believe that DCUSA Charging Objectives 1 and 2 are better facilitated by this change as there would be no negative margins on tariff components for LDNOs.</p> <p>DCUSA Charging Objective 3 is also better facilitated as there is no justification for a negative margin for LDSOs in these charging arrangements. Although we have a concern that there is a risk with the proposed approach, as some Customers may find themselves facing additional costs (albeit these will be small), although we still believe that the proposed approach does better facilitate this charging objective</p>	
BU-UK	Non-Confidential	We agree with the WG assessment that objectives 1,2 and 3 are better facilitated, and agree with the reasons provided..	
UK Power Distribution	Non-Confidential	Yes	
Northern Powergrid	Non-confidential	Yes. We agree with the working group's assessment of the charging objectives.	
IDCSL	Non-confidential	Yes, we agree with the Working Group in the Charging Objectives 2 and 3 are better facilitated – to reduce adverse impacts on competition and ensure cost reflectivity.	
SPEN	Non-confidential	Yes, objectives 1, 2, 3.	

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Indigo Networks	Non-confidential	Yes	
ENWL	Non-confidential	No. We feel more analysis of the current and future impacts on parties under competition law would be required to determine if the solution better facilitates the DCUSA Objectives.	
Scottish and Southern Electricity Networks	Non-confidential	No comment	
Working Group Conclusions:			

Company	Confidential/ Anonymous	10. Are you aware of any wider industry developments that may impact upon or be impacted by this CP?	Working Group Comments
UKPN	Non-Confidential	Not at the current time.	
BU-UK	Non-Confidential	None	

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UK Power Distribution	Non-Confidential	No	
Northern Powergrid	Non-confidential	No	
IDCSL	Non-confidential	No	
SPEN	Non-confidential	No	
Indigo Networks	Non-confidential	No	
ENWL	Non-confidential	Yes, Ofgem is intending to issue an open letter or informal consultation at the end of June which will include alternative approaches for dealing with negative residual situations in the charging methodologies. Such changes may supersede the solution put forward by this change or result in new approaches to scaling which negate the requirement for this change	
Scottish and Southern Electricity Networks	Non-confidential	No comment	
Working Group Conclusions:			

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Company	Confidential/ Anonymous	11. What date do you believe this change proposal should be implemented? Please provide rationale?	Working Group Comments
UKPN	Non-Confidential	If this change is approved prior to the end of September (which is the methodology cut-off date in DCUSA) by the Authority, we believe that 1 April 2026 is appropriate. As this change 'could' impact other charges where negative residual exists, if this date was not achieved then we believe it would need to wait until the following year (1/4/27) before taking effect	
BU-UK	Non-Confidential	We believe that this CP should be implemented on 1 April 2026 as long as this does not require a derogation (i.e. it is not approved in time for the charge setting process for the April 2026 tariffs).	
UK Power Distribution	Non-Confidential	OK for it to start applying on the next set of charges to be calculated i.e. 2026/2027.	
Northern Powergrid	Non-confidential	We agree with the working group that this should be implemented in time for setting charges for 2026/27.	
IDCSL	Non-confidential	We agree with 1st April 2026 as we believe the issue does not appear in the April 2024 and April 2025 charges in the LPN region (but could happen in the	

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		future if a change to the application of discount percentages is not amended to cater for tariff components below zero).	
SPEN	Non-confidential	2026 as requested. 2025-26 prices have been published.	
Indigo Networks	Non-confidential	asap	
ENWL	Non-confidential	If accepted, it should be implemented for the next pricing publication post acceptance.	
Scottish and Southern Electricity Networks	Non-confidential	No comment	
Working Group Conclusions:			

Company	Confidential/ Anonymous	12. Do you have any other comments?	Working Group Comments
UKPN	Non-Confidential	No.	

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BU-UK	Non-Confidential	None	
UK Power Distribution	Non-Confidential	No	
Northern Powergrid	Non-confidential	No	
IDCSL	Non-confidential	No	
SPEN	Non-confidential	No	
Indigo Networks	Non-confidential	No	
ENWL	Non-confidential	None	
Scottish and Southern Electricity Networks	Non-confidential	No comment	
Working Group Conclusions:			