



SP ENERGY NETWORKS

Regulation & Commercial

Thomas Mackenzie
Senior Analyst Distribution
Ofgem
9 Millbank
London
SW1P 3GE

Your ref

Our Ref

Date

10 December 2014

Contact / Extension

Dear Tom

Application for relief from the penalty interest, as a consequence of under recovery relating to the close out of the DPCR4 losses incentive mechanism

This application for relief relates to our licensee SP Manweb plc ("SPMW").

We refer to Ofgem's direction dated 31st October 2014 (in respect of the consultation dated 17th September 2014) in which it was directed that the value of PRT for SPMW should be "1.5" instead of "0" for the Regulatory Years commencing 1st April 2012 and 1st April 2013 in respect of under recoveries in 2011/12 and 2012/13 respectively.

In the 21st March 2014 decision on closing out the DPCR4 losses incentive mechanism Ofgem indicated that consideration would be given to applications from Distribution Network Operators (DNOs) in relation to any adverse impact or penalty as a result of the restatement of losses data or the anticipation of the residual losses incentive (PPL values) on allowed revenue under/over recovery positions. This is to prevent DNOs being unfairly penalised for under/over recovery of revenue related to the Authority's decisions not to activate the Distribution Losses Incentive Mechanism (published 16th November 2012) and the decision on closing out the DPCR4 losses incentive mechanism.

This application is a result of the anticipation of PPL values which has led to SPMW's actual revenues collected being less than 97 per cent of the allowed revenue. When we set our 2011/12 charges we anticipated that we would be facing a larger penalty under the DPCR4 losses incentive than that already accrued to the end of 2009/10. In anticipation of Ofgem's November 2012 PPL decision we decided to voluntarily under recover revenues in 2011/12 (anticipated PPL values) to reflect this larger penalty with the intention of avoiding volatility in charges for customers. During 2011/12 Ofgem initiated their consultations into the 2009/10 losses data which ultimately resulted in the removal of manifest errors in the 2009/10 underlying data and Ofgem's DPCR4 Losses close out decision. As a result it became clear to us that our ultimate losses penalty was unlikely to be as high as was indicated when we set our charges for 2011/12. This resulted in adjustments in respect of anticipated PPL values for 2012/13 to 2014/15. The following table shows the anticipated PPL values that we assumed for the regulatory years 2011/12 to 2014/15 for SPMW.

Ochil House, 10 Technology Avenue, Hamilton International Technology Park, Blantyre, G72 0HT

Telephone: 0141 614 0008

www.scottishpower.com

Table 1

Anticipated PPL £m	2011/12	2012/13	2013/14	2014/15
SPMW	-25.9	6.0	6.0	10.0
Cumulative		-19.9	-13.9	-3.9

Impact on clawback term

The impact on the clawback term for the Regulatory Years commencing 1st April 2012 and 1st April 2013 was resolved by Ofgem's direction dated 31st October 2014. However, it is now apparent that there is also a clawback term issue in 2014/15 in respect of the under recovery in 2013/14.

The following table shows the components of the July revenue return in 2013/14 and the resulting impact on 2014/15 allowed revenues of the clawback term.

Table 2

SPM Clawback £m		2013/14	2014/15
Regulated revenue		383.85	
Allowed revenue		396.24	
Over/(Under) Recovery	(a)	-12.39	
Over/(Under) Recovery %	(b)	-3.12%	
Interest rate (It)		0.50%	
Interest rate adjustment (PRt)		0.00%	
Total interest rate applied to over/(under) recovery		0.50%	
Interest		-0.07	
Correction factor applied in following year			-12.46
Interest rate adjustment if not exceeding 3% threshold		1.50%	
Total interest rate applied to over/(under) recovery		2.00%	
Adjusted Interest		-0.25	
Adjusted Correction factor applied in following year			-12.64
Variance that would result in 2014/15			-0.18

As can be seen from the above tables our decision to try to avoid volatility in charges for customers by making an early PPL adjustment in 2011/12 and the subsequent adjustments in 2012/13 and 2013/14 resulted in the under recovery of -£12.39m, see (a) in table 2, (almost wholly due to the voluntary PPL net adjustment up to 2013/14 of -£13.9m, see cumm. line in the table 1) being above the 3% threshold, see (b) in table 2, for applying the interest rate adjustment of 1.5% as set out in our Licence in paragraph 14.2 (b) of Condition CRC 14 (Distribution Charges: supplementary restrictions).

If the 1.5% interest rate adjustment was applied to the 2013/14 under recovery then our revenues in 2014/15 would be higher by £0.18m.

Our application

Please consider this application to set the value of PRt for SPMW at "1.5" instead of "0" for the Regulatory Year commencing 1st April 2014 as a result of the under recovery in 2013/14 exceeding the 3% threshold set out in our Licence in paragraph 14.2 (b) of Condition CRC 14 (Distribution Charges: supplementary restrictions) as a result of the circumstances set out in paragraph 14.3 of Condition CRC 14 (Distribution Charges: supplementary restrictions).

If you have any questions please contact Chris Elderfield or myself.

Yours sincerely

A handwritten signature in black ink that reads "Andrew Stanger". The signature is written in a cursive, flowing style.

Andrew Stanger
Licensees Finance Manager