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Date: 5 October 2009

Dear Stakeholder

Updated revenue and cost allowances, DPCR5

Today we are publishing letters we have sent to each of the DNO groups, updating our view of allowed costs and revenues for the 2010 to 2015 period. If these revised figures were carried through to Final Proposals, with no other changes to the modelling assumptions we used in Initial Proposals, allowed revenues would increase on average by 4.7% a year across the country over the DPCR5 period. This compares with the average X figure of 5.3% set out in Initial Proposals.

Attached is a graph (Chart 1) which shows how the average annual revenue increase varies across each of the 14 distribution areas. The range has narrowed since Initial Proposals, with the highest annual average increase just above 8% and the lowest at -1.3%.

I also attach tables that set out the updated total cost allowances (Tables 2 and 3) and allowed revenues (Table 1) per company, showing how these have changed from Initial Proposals. In general, our updates bring us closer to the DNO view of the costs they need for the DPCR5 period, with our cut to the DNO bid to network investment and business costs falling to 9% (£1.3bn), compared to 14% (£2.1bn) at Initial Proposals. However, new data, particularly on business rates, and changes to our financial model mean that for many DNOs the increase in average X is lower than in Initial Proposals.

We have revised our analysis in response to a range of comments on Initial Proposals, to incorporate new data from the DNOs and to complete those areas of analysis we flagged in Initial Proposals as requiring more work. Having addressed any omissions, errors and unintended consequences identified in our Initial Proposals cost assessment we think it is appropriate to draw our cost analysis to a close. However, after considering representations from DNOs and other stakeholders, the Authority may decide we should revise the cost allowance for some or all DNOs ahead of Final Proposals.

Ahead of Final Proposals, the Authority will also decide on a number of issues which could impact significantly upon allowed revenues. These include the treatment of pension costs, the cost of capital, the range of return on regulated equity companies should be able to earn under the settlement, and our final decisions on real price effects and the scope for ongoing efficiency savings. We are consulting on the treatment of pension costs and will publish our minded to position later this month.

I am aware that many stakeholders are keen to understand the combined effect of the new price control and the new structure of charges for lower voltage customers, both of which will come into effect on 1 April 2010. In our most recent consultation document on the Structure of Charges project¹, we have estimated the combined effect as at Initial Proposals. We will revise this work and place it on our website by the end of this week.

If you have any comments or queries on this letter, its attachments or the letters to the DNO groups, please contact me, copying your correspondence to dpcr5.reply@ofgem.gov.uk.

Yours sincerely

Rachel Fletcher
Partner, Distribution

¹ Electricity distribution structure of charges project: DNOs' proposals for a common methodology at lower voltages (Ref 114/09)

Chart 1 - Average annual revenue increases across the 14 distribution areas

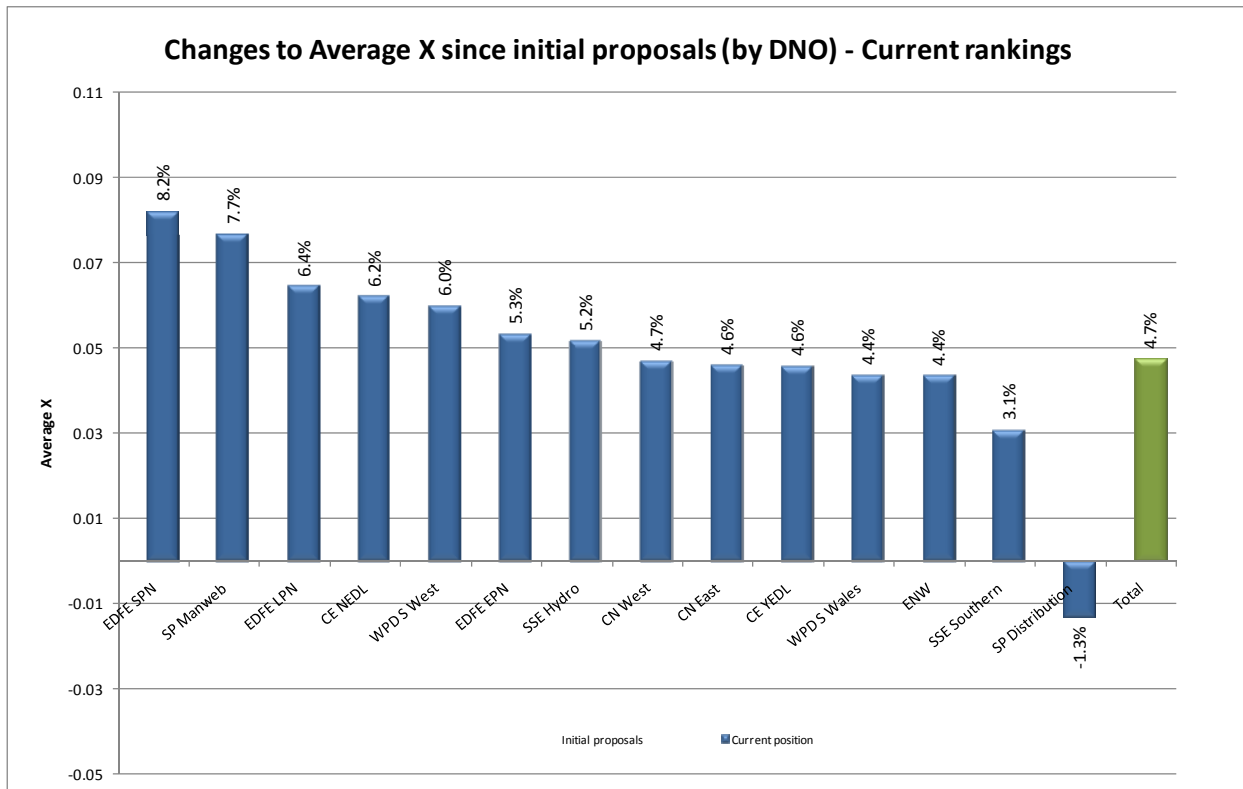


Table 1 - Total revenue allowances for each of the 14 distribution areas

CN

£m (2007-08)	Initial Proposals		October Update		Change (October - IP)	
	Allowed	Average X	Allowed	Average X	Allowed	Average X
DNO						
CN West	1658.8	4.8%	1822.6	4.7%	163.7	-0.1%
CN East	1706.4	4.9%	1850.5	4.6%	144.0	-0.3%
Total	3365.2	4.9%	3673.0	4.6%	307.8	-0.2%

ENW

£m (2007-08)	Initial Proposals		October Update		Change (October - IP)	
	Allowed	Average X	Allowed	Average X	Allowed	Average X
DNO						
ENW	1633.6	7.2%	1775.2	4.4%	141.5	-2.8%
Total	1633.6	7.2%	1775.2	4.4%	141.5	-2.8%

CE

£m (2007-08)	Initial Proposals		October Update		Change (October - IP)	
	Allowed	Average X	Allowed	Average X	Allowed	Average X
DNO						
CE NEDL	1156.3	7.0%	1250.6	6.2%	94.2	-0.8%
CE YEDL	1443.9	5.6%	1563.4	4.6%	119.4	-1.0%
Total	2600.3	6.2%	2813.9	5.3%	213.7	-0.9%

WPD

£m (2007-08)	Initial Proposals		October Update		Change (October - IP)	
	Allowed	Average X	Allowed	Average X	Allowed	Average X
DNO						
WPD S Wales	1013.4	5.0%	1102.0	4.4%	88.6	-0.7%
WPD S West	1286.2	6.3%	1394.8	6.0%	108.7	-0.3%
Total	2299.6	5.7%	2496.8	5.3%	197.2	-0.4%

EDF

£m (2007-08)	Initial Proposals		October Update		Change (October - IP)	
	Allowed	Average X	Allowed	Average X	Allowed	Average X
DNO						
EDFE LPN	1696.8	7.0%	1863.0	6.4%	166.3	-0.6%
EDFE SPN	1348.0	8.6%	1502.9	8.2%	154.8	-0.4%
EDFE EPN	2035.9	5.1%	2192.3	5.3%	156.4	0.2%
Total	5080.7	6.6%	5558.2	6.5%	477.5	-0.2%

SP

£m (2007-08)	Initial Proposals		October Update		Change (October - IP)	
	Allowed	Average X	Allowed	Average X	Allowed	Average X
DNO						
SP Distribution	1539.9	-4.3%	1711.2	-1.3%	171.3	3.0%
SP Manweb	1336.3	8.6%	1552.3	7.7%	216.0	-0.9%
Total	2876.2	0.8%	3263.5	2.5%	387.4	1.7%

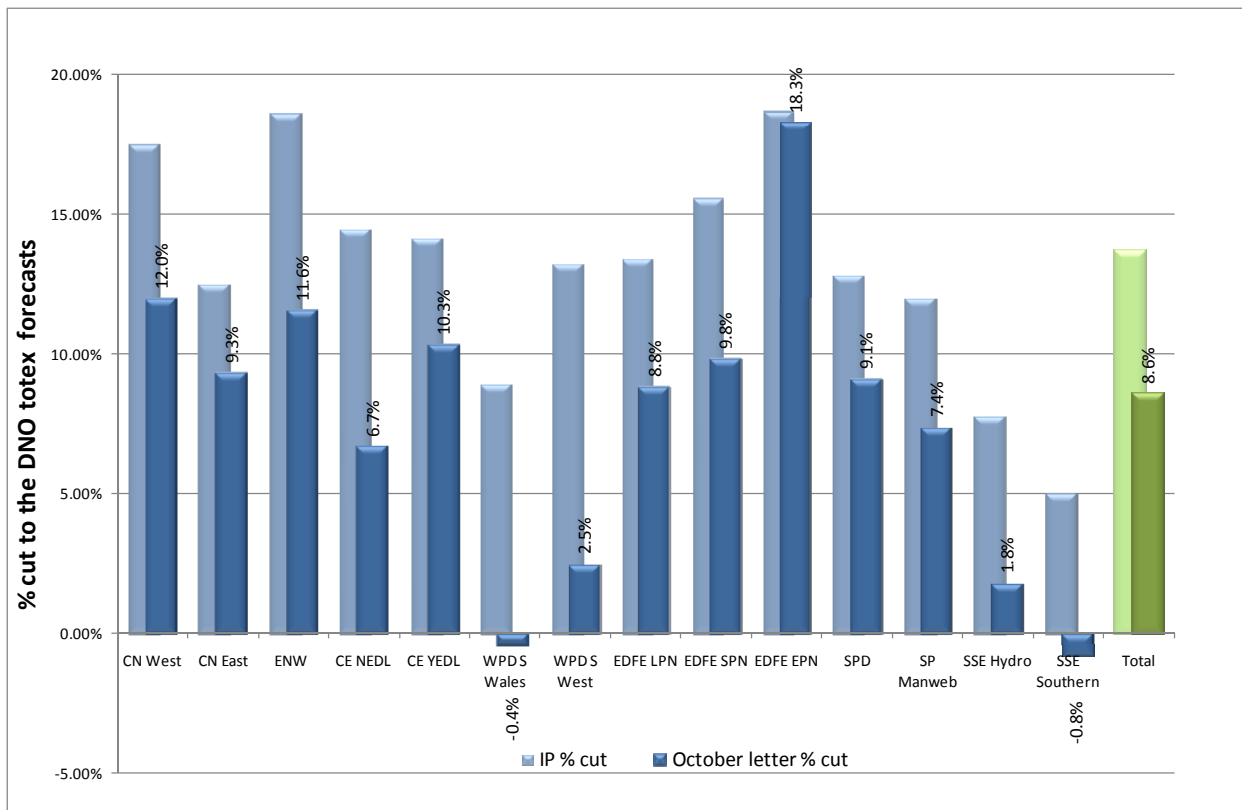
SSE

£m (2007-08)	Initial Proposals		October Update		Change (October - IP)	
	Allowed	Average X	Allowed	Average X	Allowed	Average X
DNO						
SSE Hydro	1162.7	4.5%	1341.4	5.2%	178.7	0.7%
SSE Southern	2496.5	6.9%	2444.6	3.1%	-51.9	-3.8%
Total	3659.2	6.1%	3786.0	3.8%	126.8	-2.3%

Total

£m (2007-08)	Initial Proposals		October Update		Change (October - IP)	
	Allowed	Average X	Allowed	Average X	Allowed	Average X
DNO						
Total	21514.8	5.3%	23366.6	4.7%	1851.8	-0.6%

Chart 2 – Percentage cuts to the DNOs’ totex forecasts for Initial Proposals and the October update



In the September update we proposed that costs for a number of areas where there was still a significant amount of uncertainty should be recovered through reopeners or logging up mechanisms. This had the effect of reducing our overall baseline across the DNOs by £187m.

In Table 2, in order to understand the movements in our baseline on a like-for-like basis with Initial proposals, reflecting only changes in our view of efficient costs, we have excluded areas of costs recovered through the reopener or logging up mechanism from the IP forecasts and baselines as well as the October update forecast and baselines.

In Table 3, these areas of costs are only removed from our October update baseline.

Table 2 - Total cost allowances excluding the impact of costs recovered through reopeners and the logging up mechanism

Em (2007-08) DNO	DPCR4 actuals	Initial Proposals			October Update			Change (October - IP)		
		DPCR5 Forecast	Baseline	Reduction (%)	DPCR5 forecast	Baseline Updated	Reduction (%)	DPCR5 forecast	Baseline	Reduction
CN West	1039	1324	1093	17%	1315	1157	12%	-9	64	-5%
CN East	987	1281	1121	12%	1286	1166	9%	5	45	-3%
ENW	922	1265	1030	19%	1245	1102	12%	-20	72	-7%
CE NEDL	608	826	706	14%	847	790	7%	21	84	-8%
CE YEDL	775	1077	925	14%	1138	1020	10%	61	95	-4%
WPD S Wales	432	565	515	9%	568	570	0%	3	56	-9%
WPD S West	642	843	731	13%	821	801	2%	-22	69	-11%
EDFE LPN	868	1115	965	13%	1092	996	9%	-23	30	-5%
EDFE SPN	868	1204	1017	16%	1168	1053	10%	-37	36	-6%
EDFE EPN	1410	1755	1428	19%	1717	1403	18%	-38	-24	0%
SPD	767	916	799	13%	933	848	9%	17	49	-4%
SP Manw eb	808	1130	995	12%	1131	1047	7%	1	52	-5%
SSE Hydro	469	560	516	8%	571	561	2%	11	45	-6%
SSE Southern	1092	1366	1298	5%	1365	1376	-1%	-2	78	-6%
Total	11687	15229	13139.2	13.7%	15196	13890	8.6%	-32	750	-5%

Table 3 - Total cost allowances including the impact of costs recovered through reopeners and the logging up mechanism

Em (2007-08) DNO	DPCR4 actuals	Initial Proposals			October Update			Change (October - IP)		
		DPCR5 Forecast	Baseline	Reduction (%)	DPCR5 forecast	Baseline Updated	Reduction (%)	DPCR5 forecast	Baseline	Reduction
CN West	1039	1332	1101	17%	1323	1157	13%	-9	56	-5%
CN East	987	1284	1124	12%	1289	1166	10%	5	42	-3%
ENW	922	1268	1033	19%	1248	1102	12%	-20	69	-7%
CE NEDL	608	828	709	14%	849	790	7%	21	81	-7%
CE YEDL	775	1080	928	14%	1141	1020	11%	61	92	-3%
WPD S Wales	432	567	517	9%	570	570	0%	3	54	-9%
WPD S West	642	845	733	13%	823	801	3%	-22	68	-11%
EDFE LPN	868	1173	1023	13%	1150	996	13%	-23	-28	1%
EDFE SPN	868	1214	1027	15%	1178	1053	11%	-37	26	-5%
EDFE EPN	1410	1777	1449	18%	1739	1403	19%	-38	-46	1%
SPD	767	949	832	12%	966	848	12%	17	17	0%
SP Manw eb	808	1153	1018	12%	1154	1047	9%	1	29	-2%
SSE Hydro	469	567	523	8%	578	561	3%	11	38	-5%
SSE Southern	1092	1377	1309	5%	1376	1376	0%	-2	67	-5%
Total	11687	15415	13325.8	14%	15383.0	13890	10%	-32	564	-4%