To:
Distribution Network Operators

Promoting choice and value for all gas and electricity customers

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Dear colleague,

Losses Incentive Mechanism – PPL term

This letter follows on from the workshop on the losses incentive mechanism held on Friday 2 December 2012 and sets out how we intend to handle spreading of the PPL term.

As you will be aware, under CRC7.8, the PPL term is the amount of the residual distribution losses incentive arising in DPCR4 restriction period that is to be recovered in those Regulatory years of DPCR5 that the PPL term is not set to zero. Our consideration of this matter is driven by a differential treatment of the PPL term in the current Distribution Connection Use of System Agreement (DCUSA) forecasts.

At the workshop, we considered the following 4 options for handling the spreading of the PPL term:

1. Use DNO estimates for 12/13 when directing PPL for last 3 years of DPCR5
2. Direct PPL for 12/13 as "0" when directing PPL for the last 3 years of DPCR5
3. Direct PPL for last 3 years of DPCR5 with value for 12/13 not being "0" and not being the estimates used by DNOs, allowing for potentially more even spread across 3 final Regulatory years
4. Set PPL to "0" for 12/13 by licence modification then direct PPL for the last 2 years of DPCR5 only

Having considered these options and the points raised by the DNOs, we are of the view that Option 1 would be the least disruptive and most effective way of proceeding, having taken account of the impact on revenue stability and DNO cash flows as required by the Final Proposals document. For the purposes of implementing Option 1 we will be using the forecasts that were submitted by the fifth Working Day of November 2011. DNOs will continue to be bound by the DCUSA charging and reporting provisions (including those at Clauses 19 and 35A).

We are required by CRC 7.8 to issue a direction on the setting of PPL values by 30 November 2012. We have, however, committed to providing as much notice of the PPL values (given their potential impact on charges) as early as possible and we therefore intend to issue the direction in the summer of 2012.

The aim of this letter is to provide as much clarity as we can at the moment on spreading the PPL term, following differential treatment of PPL in the current DCUSA forecasts. It should not, however, be seen as prejudicing any forthcoming decisions or work by us in developing the losses incentive mechanism.

I would be happy to discuss further should you require additional clarity on the content of this letter.

Yours sincerely

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