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Our ref

Your ref

Date

-

02 May 2012

Dear Joanna

Mitigating network charging volatility arising from the price control settlement

I am writing on behalf of Western Power Distribution (South Wales) plc, Western Power Distribution (South West) plc, Western Power Distribution (East Midlands) plc and Western Power Distribution (West Midlands) plc in response to the above consultation of 13th April 2012.

On reviewing the consultation I have set out below our thoughts on the questions raised in the consultation.

CHAPTER: Two

Question 2.1: Have we correctly characterised the scope of the problem we are trying to address?

- Yes.

Question 2.2: Are there certain market segments or groups of customers that are particularly affected by charging volatility?

- Those charged under the EDCM methodology can experience significant volatility in charges caused by unpredictable changes in the underlying data used in the EDCM methodology e.g. changes to Agreed Supply Capacities of one customer can make a significant difference to all other EDCM charges.

Question 2.3: Do you agree with the assessment criteria? Are there additional criteria that we should adopt for our final assessment?

- Agree with the criteria.

CHAPTER: Three

Question 3.1: Do you have any further suggestions of what could be done to mitigate network charging volatility arising from the price control settlement?

- No.

Question 3.2: Do you agree with our initial assessment of each option?

- No. In option 2, removal of intra-year changes will increase the volatility at the annual review time.

Specific questions in relation to option 1:

Question 3.3: Do code and licence charge notification differences in each network sector create problems in managing charge changes?

- Whilst not a significant issue, earlier notification of charges DNOs are subject to from NGT (including new charges for sites being commissioned during the charging year) would help reduce one uncertain issue.

Question 3.4: What information would you like the network operators to provide, that they currently do not, in order to help improve predictability of network charges for different customer groups? This should include:

- a) what information you would like to see in their business plan submissions, and
- b) what information you would like to see provided on an on going basis.
- We currently publish a large amount of data on the forecasts we have and use internally. We would prefer to publish the whole EDCM model but are currently prevented by the confidential data that it contains and the difficulties of getting the permissions to publish it.

Question 3.5: What information do you think we could provide, that the network operators cannot, that would benefit you in terms of improving predictability of network charges?

- A timetable of when decision will be made on charging methodology proposals.

Specific questions in relation to option 2:

Question 3.6: In the last five years how frequently have networks introduced intra-year changes? What were the main reasons for these changes?

- South West and South Wales: Changes were made in Oct 08 and Oct 11. The Oct 11 change was due to a change to the Method M model for IDNO charges. This had a very small effect on main prices.
- Mid West and Mid East: Changes were made in Nov 09 and Oct 11. The Nov 09 change was to introduce IDNO tariffs and the Oct 11 change was due to a change to the Method M model for IDNO charges. This had a very small effect on main prices.

Question 3.7: Are there any business processes that would mean only allowing one change per year on 1 April would not be feasible?

- There are business processes in place to try and mitigate the need for changes during the year. There are no business processes that require a change.

Question 3.8: Do you think that there should be exemptions that would allow for changes due to specific events? Do you think these events should include the occurrence of errors when calculating charges or changes to the charging methodologies? Are there any other events that should potentially be exempt?

- Yes there should be exemptions to allow for changes due to specific events. These exemptions should include errors but could also include extreme weather. DNOs budgets are based on the expected allowed revenue.

Question 3.9: Do you agree with our proposed change to the penalty for over or under recoveries were this option to be implemented?

- Yes

Question 3.10: Do you agree with our initial view that there should be a two year lag on adjustments due to the over or under recovery of revenue through the correction factor?

- No – The one year lag on adjustments due to the over or under recovery of revenue should remain. The inability of a NWO to recover actual costs incurred as soon as possible through a tariff change considerably increases cash-flow and earnings risk to a NWO. For example, the very mild weather in 2011/12 has resulted in a significant under recovery in revenues for WPD; a move to delay these revenues by two years considerably increases the cash flow and earnings volatility and therefore risk to WPD's shareholders.

Question 3.11: Are you aware of any errors that have been made when calculating network charges in sectors other than electricity distribution?

- Whilst we have no evidence, it is unlikely that errors have never or will never be made in calculating network charges in all sectors, unless methodologies are made very simple.

Question 3.12: Do you think that introducing an additional licence condition to penalise NWOs when they make charge calculation errors is warranted?

- No – whilst reasonable to consider penalties where the NWO does not have suitable checking procedures prior to issuing charges, these should be considered on a case by case basis. What is needed is an appropriate method within the governance process for informing users of any errors, their impact and how they are going to be corrected.

Specific questions in relation to option 3:

Question 3.13: What do you consider to be an appropriate notice period for changes to allowed revenues?

- There are already lags on QoS and Losses which are the main incentives in the electricity market in terms of value. Other incentives could have a year lag applied, but if the DNO spends money during the charging year on an incentive then they would expect to be able to build this into their prices within that year.

Question 3.14: Do you consider there to be any potential exemptions to our proposal to lag all incentive adjustments?

- We agree that all incentive mechanisms are subject to a two year lag to allow time for measurement and audit such as IIS.

Specific questions in relation to option 4:

Question 3.15: Do you agree or disagree with our initial assessment of whether a lag should be applied to the following uncertainty mechanisms? Please explain your reasoning.

- a) indexation
- b) pass through costs
- c) revenue drivers
- d) within period determinations
- e) reopeners
- f) innovation funding

- We agree with your assessment that, unlike incentive mechanisms, uncertainty mechanisms (reopeners, indexation, pass through costs, LCNF) involve actual costs that a NWO incurs so the recovery of such costs should be allowed as soon as possible without the introduction of a *further* lag.

Specific questions in relation to option 5:

Question 3.16: Do you agree or disagree with our initial assessment that the benefits of introducing one of the three options for a cap and collar do not outweigh the drawbacks?

- We agree that the benefits do not outweigh the drawbacks.

Question 3.17: Do you consider there are any other options for the design of a cap and collar mechanism that we have not considered?

- No.

Question 3.18: Do you have any views on whether a cap and collar, if implemented, should be symmetric or asymmetric?

- If implemented, it should be symmetric.

Timing of implementation:

Question 3.19: Do you agree that if changes are needed in the gas distribution or transmission sectors that they should be implemented on 1 April 2013, the start of the next price control period?

- No view.

Question 3.20: When should we apply any changes to the electricity distribution sector?

- If changes are needed, they should apply from the beginning of ED1.

Should you wish to discuss any aspects of our response please contact Nigel Turvey (nturvey@westernpower.co.uk).

Yours sincerely

A handwritten signature in black ink, appearing to be 'AS', written in a cursive style.

ALISON SLEIGHTHOLM
Regulatory & Government Affairs Manager