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14th December 2012

Dear Tim,

Consultation on restatement of 2009-10 data and closing out the DPCR4 losses incentive mechanism: response to question 8

Thank you for the opportunity to respond to this consultation. This is a non-confidential response on behalf of the Centrica Group excluding Centrica Storage.

We do not believe the proposed approach to the recovery of the PPL term is the most appropriate as it does not take account of DNO assumptions on the recovery of PPL for the regulatory year 2013/14.

- We believe that a formal direction should be made for the 2013/4 PPL value consistent with the DNO assumptions in DUoS tariff setting.
- Ofgem should take account of the effect of the unwinding of the 2013/14 PPL assumption before deciding the recovery profile of PPL.
- This revised residual PPL value (after taking account of the 13/14 assumption) should be spread equally over 2 years or alternatively over a DNO specific number of years depending on the materiality of the residual amount.

PPL value for 2013/14:

We welcomed Ofgem's previous decision to give guidance to DNO's to set 2013/14 DUoS charges on the basis of the PPL estimates contained in their May 2012 DCUSA forecasts. We also welcome DNO's willingness to follow this guidance. However we remain of the opinion that this arrangement needs to be put on a formal footing by including the 2013/14 PPL estimates assumed in DNO's tariff setting in the Ofgem PPL direction to be issued by 1 April 2013.

In paragraph 3.37 of the consultation, it is suggested that the Special Licence Condition CRC7, which was modified on 1 October 2012, only allows the PPL term to be recovered over three years, being the final year of DPCR5 (2014/15) and the first two years of RIIO ED1. We do not believe this to be

the case; paragraph 7.8B of Special Licence Condition 7 permits Ofgem to direct a value for PPL for any year between 2012/13 and 2016/17¹.

For some DNOs, setting 2013/14 DUoS tariffs using the 2013/14 PPL value included in their May 2012 DCUSA forecast will result in under recoveries greater than 3% of allowed revenue which will have a negative impact on the level of interest applied to this under recovery². This is likely to result in requests from DNOs for relief from the consequences of these large under recoveries which in turn would require further industry consultation. This seems to us to be an unnecessary burden to place on the industry since it could be avoided simply by formalising the 2013/14 PPL assumption in the PPL direction to be issued by 1 April 2013.

PPL values for future years:

With regards to the PPL values contained in table 6 of the consultation, we do not think that these are the correct values on which to base a decision on the recovery profile of the residual PPL amounts since they do not take account of the PPL assumptions inherent in 2013/14 DUoS charges. Regardless of whether or not Ofgem decide to formalise the PPL value assumed for 2013/14 tariffs, we believe that they need to take account of the assumption if they are seeking to avoid undue volatility in DUoS tariffs.

We understand that the 2013/14 PPL assumption that DNOs will be including in their DUoS tariffs will amount to -£81m. If Ofgem ignore this in their profiling decision of the residual PPL amount then all of this £80m will be recovered in 2014/15 on top of the proposed 50% of the minded-to PPL value contained in the Ofgem consultation. This will result in the PPL recovery and tariff profile contained in Table 1 (holding everything constant except the PPL assumption):

Table 1	2013/14	2014/15	2015/16	2016/17
Ofgem Approach	DNO Assumption	50% Ofgem PPL – 13/14 DNO assumption	50% Ofgem PPL	
PPL	-£81m	+£114m	+£33m	£0
2013/14 Base Allowed Revenue	£5,514m	£5,514m	£5,514m	£5,514m
PPL Adjusted Allowed Revenue	£5,433m	£5,628m	£5,548m	£5,514m
Tariff change due to PPL profile	-1.5%	3.6%	-1.4%	-0.6%

As can be seen, the effect of ignoring the 2013/14 PPL assumption is to create a £195m swing between 2013/14 revenues and 2014/15 revenues. For some DNOs this swing is over 20%.

If Ofgem wish to recover the PPL amount over two years for all DNOs, we suggest that Ofgem must first of all add the effect of the 2013/14 PPL assumption to the minded-to PPL values contained in the consultation and then recover this amount equally over two years. This will result in the PPL recovery and tariff profile contained in Table 2 below, which reduces the tariff volatility compared to Table 1.

¹ The amount of PPLt assigned for recovery in respect of subsequent Regulatory Years will be set in a direction given by the Authority no later than 1 April 2013 following consultation with the licensee and all other Distribution Services Providers. That direction will set out the period over which the value of PPLt is to be recovered, and such period shall not commence before the Regulatory year beginning 1 April 2012 and shall not extend beyond the end of the Regulatory Year beginning 1 April 2016.

² See Part A of CRC 14. Distribution Charges: supplementary restrictions

Table 2	2013/14	2014/15	2015/16	2016/17
Suggested Approach 1	DNO Assumption	50% Ofgem PPL – 13/14 DNO assumption	50% Ofgem PPL	
PPL	-£81m	+£74m	+£74m	£0
2013/14 Base Allowed Revenue	£5,514m	£5,514m	£5,514m	£5,514m
PPL Adjusted Allowed Revenue	£5,433m	£5,588m	£5,588m	£5,514m
Annual tariff change due to PPL	-1.5%	2.8%	0.0%	-1.3%

A further option worth considering to is to add the effect of the 2013/14 PPL assumption to the minded-to PPL values contained in the consultation (as above) and then recover this amount over a number of years specific to each DNO. Given that DNOs should be neutral to the profile of the recovery of PPL we do not consider this particular area of the close out of the losses incentive necessarily needs to be performed on a common basis.

Table 3 below shows the effect of this option which spreads the recovery of the remaining PPL amount (minded-to value in the consultation plus the unwinding of the 2013/14 assumption) over 1, 2 or 3 years depending on the materiality of the amount to be recovered. We have shown the effect of an approach which recovers residual values less than £10m in a single year, values between £10m and £20m over two years and values greater than £20m over three years. Ofgem may have an alternative view on the appropriate materiality thresholds but we believe that there is merit in the principle of this approach.

Table 3	2013/14	2014/15	2015/16	2016/17
Suggested Approach 2	DNO Assumption	50% Ofgem PPL – 13/14 DNO assumption	50% Ofgem PPL	
PPL	-£81m	+£52m	+£51m	£44m
2013/14 Base Allowed Revenue	£5,514m	£5,514m	£5,514m	£5,514m
PPL Adjusted Allowed Revenue	£5,433m	£5,567m	£5,565m	£5,559m
Annual tariff change due to PPL	-1.5%	2.4%	0.0%	-0.1%

We include with our response a spreadsheet (Recovery Options.xlsx) which shows the tariff calculations supporting figures in the above tables and also provides the tariff movements on a DNO by DNO basis. Our preference would be an approach based on Table 3 above (suggested approach 2), with the approach suggested in table 2 also acceptable (suggested approach 1). We are not supportive of Ofgem’s current proposed approach (reflecting in table 1 above) since it fails to take account of DNO assumptions on the recovery of PPL for the regulatory year 2013/14.

I trust these few comments are helpful, if you have any questions regarding any of the points raised in this response please do not hesitate to get in touch.

Kind regards,

Andy Manning
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British Gas
[via e-mail]