



Making a positive difference
for energy consumers

Distribution Network Operators

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Dear Company Secretary,

Direction pursuant to paragraph 7.7 of Charge Restriction Condition (CRC) 7 of the Electricity Distribution licence

We included a Losses Incentive Mechanism in the Fourth Distribution Price Control (DPCR4). This mechanism was designed to drive the Distribution Network Operators (DNOs) towards achieving an efficient level of losses on their distribution networks. Our March 2014 decision¹ published alongside this Direction sets the residual reward or penalty (represented by PPL_t) for each DNO area and closes the incentive mechanism.

In accordance with CRC 7 and our March 2014 decision, the Authority hereby directs the PPL_t term for each DNO area for the regulatory years 2015/16 to 2022/23 in the Schedule to this Direction.

This Direction constitutes notice of the reasons for the Authority's decision pursuant to section 49A of the Electricity Act 1989.

Hannah Nixon
[Produced electronically]

**Senior Partner
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¹ <https://www.ofgem.gov.uk/publications-and-updates/further-consultation-restatement-2009-10-data-and-closing-out-dpcr4-losses-incentive-mechanism>

Schedule

1. The PPL value for each DNO licence area

Table 1 contains the PPL value for each DNO area. Column one contains the values from our March 2014 decision and are based on our assessment of restatement submissions, where appropriate. The values are calculated on losses performance for each DNO in 2009/10 prices and are net of the rewards or penalties they have each already received or incurred under the incentive. Column two contains the PPL values inflated by the retail prices index term (RPI_t)² to 2012/13 prices.

The PPL values in column one have been calculated in accordance with CRC 7 and by reference to the methodology set out in the Authority's decision document published on 3 January 2013 (ref 01/13),³ using the following formula:

close out = total incentive – Σ incentive over DPCR4

Where:

Total incentive is five times the 2009/10 close out incentive value ('5xE')

Σ incentive over DPCR4 is the sum of 'Incentive for Units distributed after 1.4.2005' from 2005/06 to 2009/10 as reported in the DPCR4 revenue returns.

2. The period of recovery

The PPL_t values in 2012/13 prices for the regulatory years 2015/16 to 2022/23 are contained in Table 2.

The impact of recovery in each year has been limited to no more than three per cent of forecast allowed revenue in the regulatory year 2015/16 for each licensee. The exception to this is 2016/17 where the value takes into account correction factor adjustments resulting from DNOs' provision for PPL recovery prior to 2015/16.⁴ The effect of this is to smooth the impact of the PPL on DNO revenues and resulting Use of System Charges. The calculations for this apportionment are published as an Appendix to the accompanying decision document.

Values of PPL_t in Table 2 are to be inflated from 2012/13 to the price base for the year of recovery.⁵ Consistent with our decision document, this is achieved by inflating the values by the Average Specified Rate plus a margin of 1.5 for every year from 2012/13 up to and including the regulatory year of recovery. For each year of inflation the Average Specified Rate is to be based on the calculated rate for the previous regulatory year, t-1.

To reach a value of PPL_t in the price base for the regulatory year of recovery, values should be inflated in accordance with the following formula until the amount left to recover is zero:

² As defined in CRC 2 of the electricity distribution licence.

³ <https://www.ofgem.gov.uk/publications-and-updates/decision-methodology-closing-out-dpcr4-losses-incentive-mechanism>

⁴ Prior recovery and its impact are explained in the decision document that accompanies this direction.

⁵ The precise values of PPL_t in Table 6 of Appendix 2 of the decision document are to be used.

$$PPL_t = PPLD_t \times \left(1 + \left(\frac{I_{t-n} + 1.5}{100}\right)\right) \times \left(1 + \left(\frac{I_{t-n+1} + 1.5}{100}\right)\right) \times \left(1 + \left(\frac{I_{t-n+2} + 1.5}{100}\right)\right) \\ \times \dots \left(1 + \left(\frac{I_{t-1} + 1.5}{100}\right)\right)$$

Where:

t is the regulatory year of recovery of the PPL term.

n is the number of years elapsed from year 2012/13 to year t , calculated by:
 $n = t - 2012/13$

$PPLD_t$ means the values of PPL_t in 2012/13 prices given in Table 2 in this direction.

I_t means the Average Specified Rate in regulatory year t .

Average Specified Rate means the arithmetic mean value of the Bank of England's Official Bank Rate during the period in respect of which the calculation in question is made.

By way of illustration, the following equation applies the formula to the calculation of the PPL term for recovery in 2015/16 (where $n = 3$):

$$PPL_{15/16} = PPLD_{15/16} \times \left(1 + \left(\frac{I_{12/13} + 1.5}{100}\right)\right) \times \left(1 + \left(\frac{I_{13/14} + 1.5}{100}\right)\right) \\ \times \left(1 + \left(\frac{I_{14/15} + 1.5}{100}\right)\right)$$

Table 1. PPL values by licensee in 2009/10 and 2012/13 prices

DNO	PPL in 2009/10 prices (£)	PPL in 2012/13 prices (£)
Electricity North West Limited (ENWL)	-19,497,857.66	-21,388,040.37
Northern Powergrid (Northeast) Ltd (NPgN)	-9,523,812.50	-10,447,080.38
Northern Powergrid (Yorkshire) plc (NPgY)	-25,101,046.38	-27,534,419.55
Western Power Distribution (Midlands West) plc (WPD WMID)	-18,838,257.16	-20,664,496.16
Western Power Distribution (Midlands East) plc (WPD EMID)	-74,573,127.73	-81,802,477.68
Western Power Distribution (South Wales) plc (WPD SWALES)	-6,752,260.32	-7,406,845.35
Western Power Distribution (South West) plc (WPD SWEST)	-9,687,639.64	-10,626,789.43
Eastern Power Networks plc (UKPN EPN)	-71,400,138.13	-78,321,888.65
London Power Networks plc (UKPN LPN)	-2,262,060.25	-2,481,351.38
South Eastern Power Networks plc (UKPN SPN)	-8,801,197.88	-9,654,413.26
Scottish Power Distribution Ltd (SPD)	12,644,533.95	13,870,334.23
Scottish Power Manweb plc (SPMW)	4,941,532.03	5,420,579.45
Southern Electric Power Distribution plc (SSES)	45,995,550.06	50,454,501.13
Scottish Hydro Electric Power Distribution plc (SSEH)	22,020,036.24	24,154,726.75
Total	-160,835,745.38	-176,427,660.64

Table 2. PPL_t values for each licensee in 2012/13 prices (£ million)

These numbers are to be inflated by the formula in this direction to derive the value of PPL_t for each year.

DNO	2015/16	2016/17	2017/18	2018/19	2019/20	2020/21	2021/22	2022/23
	PPLD _{15/16}	PPLD _{16/17}	PPLD _{17/18}	PPLD _{18/19}	PPLD _{19/20}	PPLD _{20/21}	PPLD _{21/22}	PPLD _{22/23}
Electricity North West Limited (ENWL)	-10.89	-10.50	0.00	0.00	0.00	0.00	0.00	0.00
Northern Powergrid (Northeast) Ltd (NPgN)	-7.92	-2.53	0.00	0.00	0.00	0.00	0.00	0.00
Northern Powergrid (Yorkshire) plc (NPgY)	-10.36	-10.36	-6.82	0.00	0.00	0.00	0.00	0.00
Western Power Distribution (Midlands West) plc (WPD WMID)	-11.86	-8.81	0.00	0.00	0.00	0.00	0.00	0.00
Western Power Distribution (Midlands East) plc (WPD EMID)	-11.90	-55.13	-11.90	-2.87	0.00	0.00	0.00	0.00
Western Power Distribution (South Wales) plc (WPD SWALES)	-6.14	-1.27	0.00	0.00	0.00	0.00	0.00	0.00
Western Power Distribution (South West) plc (WPD SWEST)	-8.86	-1.76	0.00	0.00	0.00	0.00	0.00	0.00
Eastern Power Networks plc (UKPN EPN)	-15.41	-59.10	-3.81	0.00	0.00	0.00	0.00	0.00
London Power Networks plc (UKPN LPN)	-2.48	0.00	0.00	0.00	0.00	0.00	0.00	0.00
South Eastern Power Networks plc (UKPN SPN)	-9.65	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Scottish Power Distribution Ltd (SPD)	10.66	3.22	0.00	0.00	0.00	0.00	0.00	0.00
Scottish Power Manweb plc (SPMW)	5.42	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Southern Electric Power Distribution plc (SSES)	15.45	27.54	7.47	0.00	0.00	0.00	0.00	0.00
Scottish Hydro Electric Power Distribution plc (SSEH)	8.16	8.12	7.88	0.00	0.00	0.00	0.00	0.00
Total	-55.79	-110.57	-7.19	-2.87	0.00	0.00	0.00	0.00

