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29th April 2014

Tom Mackenzie
Ofgem
9 Millbank
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Dear Tom,

NOTICE UNDER SECTION 11A(2) OF THE ELECTRICITY ACT 1989

With regards to the proposed modifications to the special conditions of the four electricity distribution licences held by Western Power Distribution, we would like to draw your attention to the below areas of concern which we consider require clarification and correction as appropriate in order to ensure that the interests of consumers are upheld. We consider a number of these to be both serious and material in nature and are further concerned that we have reached a relatively late stage in the process with such significant issues remaining.

- **Potential inconsistency with Ofgem's previous decision on the setting of 2015/16 revenues**
- **Ability of Ofgem to direct changes to Charge Restriction Condition without representation from interested parties**
- **RPI forecast used for the purposes of the Tax Allowances**
- **CRC 3K. Rail electrification adjustments**
- **Calculation of the correction factor**

Potential inconsistency with Ofgem's previous decision on the setting of 2015/16 revenues:
The wording of Charge Restriction Condition 4C (Price control update provisions for WPD) allows for the Opening Base Revenue Allowances of any year of RIIO ED1 to be re-profiled for the WPD licencees. This is inconsistent with Ofgem's 19th December 2013 decision on "**The timing of a decision on electricity distribution networks' revenue for 2015-16**". In that decision, Ofgem stated that ~~for~~ the 2015-16 revenues for fast-tracked DNOs will be fixed at the fast-track Final Determination, with any required revenue deferral (either positive or negative) recovered over the remaining years of RIIO-ED1. We are assuming that policy in this respect has not changed, and believe that the licence conditions should accurately reflect the policy.

Ability of Ofgem to direct changes to Charge Restriction Condition without representation from interested parties:

Charge Restriction Condition 4C enables Ofgem to update price control allowances for WPD. Whilst Part A (Updating of Stipulated Values at Slow-Track) explicitly provides for representations to be made by interested parties and considered by Ofgem, we are concerned that for the adjustments provided for in Part B (Financial adjustments) and Part D (Updating Part 4 and the ED1 Price Control Financial Instruments), the licence wording does not explicitly allow for formal representations to be made by interested parties. We assume that this is unintentional but the wording in these sections needs to be corrected to provide clarity that the views of interested parties will be sought prior to any adjustments being made and that Ofgem will duly consider any such representations.

RPI forecast used for the purposes of the Tax Allowances:
We have identified that the RPI forecast used in the PCFM for WPD is different (lower) to that assumed by the other DNOs in their revised business plans (2.8% vs 3.1%) and note that this lower forecast of RPI acts to **increase** the tax allowance of the WPD licensees by the following amounts:

RPI - 2.8% vs 3.1%	31 Mar 2016	31 Mar 2017	31 Mar 2018	31 Mar 2019	31 Mar 2020	31 Mar 2021	31 Mar 2022	31 Mar 2023	RIIO Total	RIIO average
WMID	0.7	0.7	0.7	0.7	0.6	0.6	0.6	0.6	5.2	0.6
EMID	0.7	0.7	0.6	0.6	0.6	0.6	0.6	0.6	4.9	0.6
SWALES	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	2.5	0.3
SWEST	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	3.8	0.5
WPD TOTAL	**2.2**	**2.1**	**2.1**	**2.1**	**2.0**	**2.0**	**2.0**	**2.0**	**16.4**	**2.0**

Clearly it is inappropriate for WPD customers to pay an additional £16m simply because the RPI forecast has not been updated to reflect the latest view. Ofgem will need to correct this anomaly as part of the process of ensuring the detail of the Common Content of the ED1 Price Control Financial Instruments is exactly similar to that for every other Electricity Distributor as provided for by Part D of Charge Restriction Condition 4C and confirmation of this would also be welcome.

More generally, we consider that the RPI figure used for tax calculations should be updated each year with the PCFM annual iteration to ensure that revenue allowances remain appropriate and consistent with other cost allowances.

We are concerned however that 4.10 of the financial handbook states "*The PCFM uses nominal prices for some internal tax calculation functions. For this purpose, the PCFM refers to RPI forecast values set at the outset of the Price Control Period.*" This suggests that the RPI forecast used to determine initial tax allowances will not be updated annually. This seems to us a highly unusual policy and would result in customers in the 4 WPD regions, simply by virtue of Ofgem assuming a lower RPI figure for these licensees, paying an additional £16m in DUoS charges over RIIO ED1 relative to customers in other regions.

CRC 3K. Rail electrification adjustments:
A significant area of concern we have is in relation to the treatment of allowed Rail Electrification costs. WPD included £96m in their business plan for these costs which other DNOs consider will be paid for by Network Rail and Ofgem have provided an ex-ante allowance to recover these highly uncertain costs. We previously expressed our concern that placing this funding in WPD's allowances

at this stage may make it more difficult to be removed later and stated that our preference for the default position was to exclude such costs.

Our concern in this area has now increased considerably. It would appear from Ofgem's response to comments received to the informal license consultation that Ofgem only intend to amend WPD's settlement in the situation where a third party is funding the costs associated with rail electrification that WPD has been funded for, and **do not** intend to adjust allowances, other than through the Totex mechanism, in any instances where these uncertain costs do not actually materialise at all or are delayed. This means that WPD will be able to retain, and their customers will be required to fund, 70% of any such costs which have not materialised.

We consider this would be highly inappropriate, and clearly unacceptable, and are further concerned that other DNOs, in their revised business plans, have decided that they would like to include a similar funding arrangement for these highly uncertain costs despite not receiving any actual notices of a diversion request from Network Rail.

Calculation of the Correction Factor:
Ofgem are proposing to set the correction factor to zero for 2015/16. We are generally comfortable with this however our comments here are in relation to the recovery of revenues associated with the "£5 rebate". Whilst we are sympathetic to, and indeed expectant of, the recovery of these revenues in 2015/16, we would not welcome any proposal to allow the recovery of more general under recoveries in 2015/16. Our concern here is with respect to the recent PPL direction made by Ofgem which contained values which specifically factored in the two year lag in the correction factor during RIIO ED1. Therefore any change to the current proposal for the calculation of the correction factor to deal with the recovery of the "£5 rebate" would need to ensure that it does not create a price shock with respect to the current expected impact on revenues associated with the close out of the DPCR4 losses incentive.

We hope you find our comments helpful. Please do not hesitate to contact me if you have any questions.

Yours sincerely,

Andy Manning
Head of Network Regulation, Forecasting and Settlements