WESTERN POWER DISTRIBUTION
Serving the Midlands, South West and Wales

Avonbank
Feeder Road
Bristol
BS2 0TB

Telephone 0117 9332382
Email nrichardson@westernpower.co.uk

Thomas Mackenzie
RIIO-ED1
Ofgem
9 Millbank
London
SW1P 3GE

Our ref	Your ref	Date
-		25 April 2014

Dear Tom

RIIO-ED1: Statutory Consultation on licence drafting –Distribution Licence Standard Conditions, Fast Track Charge Restriction Conditions, WPD Financial Handbook Part 1 and WPD PCFM.

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 consultations published on 28 March 2014 in relation to its Fast Track Licences.

WPD has worked closely with Ofgem and the Licence Drafting Working Group over the last 12 months to ensure that the licence conditions are consistent with Ofgem March 2013 RIIO ED1 Strategy Decision Document and other relevant policy decisions. We acknowledge that Ofgem's issues log has documented Ofgem's response to queries and differences of opinion, and accept Ofgem's position on these matters.

Overall we are happy with the drafting of the standard licence conditions and CRCs, subject to the representation on CRC4C below and the correction of factual errors, clarifications and formatting.

We have written to Ofgem separately to seek to address the under-recoveries arising from the treatment of the £5 rebate and the PPLt Residual Losses term, which we raised in our response to the Informal Consultation in February.

We recognise that the Financial Handbook describes the operation of a complex PCFM model which can be difficult to express accurately in words. We have some further points of accuracy on the Financial Handbook, and are happy to work with Ofgem to discuss this further.

<u>Representation on CRC4C</u>

4C.2 enables the Authority, by way of direction, to bring Stipulated Values, as set out in the ED1 Final Determination, up to date. Ofgem's 28th February Fast Track Final Determination for WPD described changes that may be needed to WPD's licence at Slow Track, in the section headed

"Financial elements and DPCR5 close-out amounts". However this list of items is not consistent with the list included in CRC4C Part A Updating Stipulated Values published on 10th January 2014, that we responded to on 7th February. The table below compares the two lists.

In particular we would like "*allocations to tax pools, which are set on a generic basis across all DNOs"* added to the CRC4C list of Stipulated Values to reflect WPD's Final Determination more closely.

Final Determination 28 February Financial elements and DPCR5 close-out amounts to be finalised after the fast-track decision	***CRC4C Draft 28 March Statutory Consultation The Stipulated Values, which may be updated by direction of the Authority under this Part A:***	***Comment***	***Representation***
the allowed rate of return on debt, which is based on an index	*the allowed percentage cost of corporate debt for the licensee*		
	RAV additions for the licensee for Regulatory Year 2013/14		
allocations to tax pools, which are set on a generic basis across all DNOs			This item needs to be added to the list of Stipulated Values in Part A as it is not adequately covered by 4C.2(e) (to make the detail of the Common Content of the ED1 Price Control Financial Instruments exactly similar as that for every other Electricity Distributor.
	tax pool balances for the licensee as at 31 March 2014, that take account of Totex expenditure by the licensee in Regulatory Year 2013/14		
allowances for recovery of pension deficit, which we set following triennial pension reasonableness reviews		Please can Ofgem confirm that the reason why no provision to update pension deficit allowance is included in 4C is because as previously advised by Ofgem, the provisions in CRC 3C mean that the Authority can make EDE revisions for WPD for the purpose of the Annual Iteration Process that	

		will take place in November 2015.	
	Pension Scheme Established Deficit true-up value forecasts for the licensee that take account of pension payments by the licensee in Regulatory Year 2013/14	Please can Ofgem confirm that the 2013/14 true up is calculated by Rows 10-16 in table 3.2 of the Financial Handbook that calculates the true up for the whole of the DPCR5 period.	
legacy adjustments from DPCR5, which could affect both base revenue and the opening regulatory asset value (RAV) for RIIO-ED1		This is being dealt with through the "Legacy Package"	
We will subsequently revise WPD's settlement to reflect actual finance and DPCR5 close-out amounts. This will not change WPD's opening base revenue allowances for 2015-16.		This is being dealt with through the "Legacy Package"	
In our cost of equity decision we stated that we would also use the 'no worse off' commitment if we decide to increase our estimate of the cost of equity for DNOs.			
Since the slow-tracked DNOs will resubmit their innovation strategies as part of their plan resubmissions in March 2014, we stated that we would allow any fast-tracked DNO to submit a revised innovation strategy at the same time. ….At this time, WPD's NIA is 0.5 per cent of base revenue. Final NIAs will be set as part of the final determinations for slow-tracked DNOs in November 2014, and we will update WPD's at the same time.		WPD has not proposed a different amount	

Query on CRC 3D – Innovation Roll-Out Mechanism

We accept Ofgem's view that if another DNO is already using the "innovation" as ordinary business, then IRM would not apply. However our understanding was that, within the same application window, a DNO Group, or one or more DNO groups could make multiple applications to roll-out the same innovation, as long as it met the criteria. Please could Ofgem confirm that the licence drafting is intended to allow multiple applications for the same innovation within the same application window. It would be helpful to replace "license" in the definition of Ordinary Business Arrangement with "Distribution Services Provider" as this limits knowledge transfer between sectors.

Representations on the Financial Handbook

We understand that Ofgem has arranged a meeting with DNOs to take further comments on the Financial Handbook. WPD has the following points of accuracy and clarity. The most significant of these comments are those on Chapter 3 Pensions. See Appendix 1.

We look forward to further discussions with Ofgem to address the issues that we have identified.

Yours sincerely

NATASHA RICHARDSON
Regulatory Compliance Manager

Appendix 1

WPD Representations on the Financial Handbook

Chapter Reference	Current Drafting	Correction
Chapter 2 Table 2.1: **Column 5**	**Substantive** It is stated in the 5th column of the table that the values as at 1 April 2015 for ALC, ANLR, ANLO, AFE, ARP, ACO and TRE are equal to allowed expenditure levels.	This is not the case; no values are included in the PCFM variable values table as at 1 April 2015. Variant and non-variant allowances for Load related, non-load related (asset replacement), non-load related (other) etc. are included elsewhere in the PCFM and these values are used in the Totex calculations until entries are made in the PCFM Variable Values table and the year t in the PCFM is set to 2017 or beyond (i.e. when actuals have been reported).
Chapter 2 Table 2.1: Column 6	**Substantive** The 6th column states that revised values to RIRAV, RIREV, OLRAV and OLREV are i) incremental change to tax pool balances and ii) recalculated base revenue figures.	Based on the latest version of the Legacy workbook that we have seen, this should state that: • RIREV values are revenue adjustments to the RLM revenue adjustment and RAV rolling incentive revenue adjustment that were included in Opening Base Revenue; • RIRAV values are adjustments to the RAV for updates to the DPCR5 RAV additions included as at 1 April 2015; • OLREV values are revenue adjustments to the revenue adjustment for Other Legacy Items that was included in Opening Base Revenue; and • OLRAV values are adjustments to the RAV for updates to the Pensions RAV adjustment included as at 1 April 2015, and adjustments to the RAV for logged up costs.
Chapter 3 - Pensions Table 3.2: Row7	**Substantive** Row 7 states that *DR is the discount rate specified in the licensee's Scheme Valuation Data Set or, if applicable, a different rate determined under the Reasonableness Review*.	Clarification should be included here regarding the reasons for changing the discount rate, how any new discount rate should be determined and how this would be agreed with DNOs.
Chapter 3 - Pensions Table 3.2: Row 9	**Substantive** The calculation in Row 9 spreads the remaining amount of the DPCR4 opex adjustment over the remaining years of the notional 15 year PSED repair period (i.e. up to 2025). However, the calculations behind the adjustment for DPCR4 opex included in opening EDE values spread the DPCR4 opex true up over the ED1 period only.	The wording and formula in row 9 should therefore be changed to reflect this. It is much more logical and straightforward to do this and avoid these small adjustments from DPCR4 adding more complexity to ED2 calculations. The formula in row 9 should therefore be: *RA1=RC/((1-(1+DR)^-5)/LN(1+DR))*

Chapter 3 - Pensions Table 3.2: Row 14	**Substantive** Row 14 – this is an important step in the calculation and should be clarified and included in the algebra.	Proposed wording in red is: *Any adjustment amount "RD" (in 2012/13 prices) relating to the licensee's payment history in Regulatory Years 2010/11 to 2016/17, that was included in the calculation of the licensee's Opening EDE values for Regulatory Years up to and including regulatory year 2017/18 will be calculated and deducted from the value of FTotal in row 15.* The formula in row 15 should then be updated to reflect this as follows: *$G1=(F_{Total} - RD)/((1-(1+DR)^{-7})/LN(1+DR))$*
Chapter 3 - Pensions Table 3.3: Row 15 Paragraph 3.37	**Substantive** The RA1 adjustment for the DPCR4 Opex true up calculated in Table 3.2 has disappeared from this calculation. This adjustment is calculated to be included in EDE until 2025 in table 3.2 (although this should be until 2023 – see earlier comment) so this needs to be included in the subsequent EDE calculation.	To correct this, the formula in row 15 should be: *EDE = C2 + RA2 + G2 + RA1* A row should be included in Table 3.3 detailing how RA1 has been calculated (can simply be repeated from Table 3.2). – the term RA1 should be included, as follows: *3.37 If the difference between the assets and corresponding liabilities referred to in paragraph 3.6 represents a surplus position for the PSED as at 31 March 2019, then values for C2 (see row 7 in table 3.3) for Regulatory Years from 2021/22 onwards will be revised to zero pending the next review process. However, if applicable, a calculation of the adjustment relating to the licensee's payment history would still be carried, giving a value for the terms RA1, RA2 and G2 (which may be negative values) which, in that circumstance, would give the value of the term EDE for Regulatory Years 2021/22 and 2022/23 pending the next review process. The policy position with regard to pension scheme surpluses is set out in paragraphs 1.11 to 1.14 of the Authority's Strategy decision for RIIO-ED1 - Financial issues supplementary annex - see associated document b.*
Chapter 4 - Tax Paragraph 4.8:	**Substantive** **This needs to be provided for in CRC4C see** *"allocations to tax pools, which are set on a generic basis across all DNOs"*	This should state that: *4.8 Tax liability allowance calculations under the Annual Iteration Process make use of regulatory tax pool balance figures held within the PCFM. The opening balances (as at 1 April 2015) for these tax pools may be subject to legacy price control adjustments through revisions to LTPG, LTPS, LTPD and LTPS PCFM Variable Values. These adjustments are covered in chapter 14. The allocation of component elements of allowed Totex expenditure to capital allowance pools and revenue expenditure in the PCFM was fixed at the time of setting Opening Base Revenue Allowances or, for Fast Tracked licensees, updated after the Fast Track decision but prior to 1 April 2015 and will not be updated in the Price Control Period.*

Paragraph 4.18:	**Substantive** There is currently no materiality threshold for tax trigger events included in the Fast Track Final Determination Financial Model. However para 5.4 of the Financial Issues Part of the Strategy Decision Document Page 33 specified a materiality threshold of 0.33% of Opening Base Revenue for each Regulatory Year.	Insert provision for a materiality threshold for tax trigger events of 0.33% of Opening Base Revenue for each Regulatory Year in the Financial handbook and PCFM.
Paragraph 4.39: Part (v)	**Minor**	*(v) The PCFM copy will be put into 'tax trigger tool mode' using the selector on the ~~User Interface~~ Tax Trigger worksheet.*
Paragraph 4.56:	**Minor**	*4.56 Ofgem will divide the licensee's net debt figure as at 31 March in Regulatory Year t-2 (see paragraph 4.52(i)) by the licensee's indicative PCFM RAV balance (see paragraph ~~4.52(ii~~ 4.51) as at 31 March in Regulatory Year t-2 to calculate the licensee's gearing ratio.*
Paragraph 4.58:	**Minor**	*4.58 Ofgem will subtract the modelled figure for tax-deductible interest payable by the licensee in Regulatory Year t-2 (see paragraph 4.50~~2~~(i)) from the licensee's reported figure for tax deductible net interest paid during Regulatory Year t-2 (see paragraphs 4.52(ii) and 4.53). For the purpose of this calculation, amounts of interest payable are treated as positive numbers.*
Paragraph 4.59:	**Minor**	This should read: *4.59 If the result of the calculation set out in paragraph 4.5~~6~~8 is a positive value, demonstrating a positive benefit, then a tax clawback adjustment is applicable.*
Paragraph 4.60	**Minor**	Similarly, should read: *4.60 If the result of the calculation set out in paragraph 4.5~~6~~8 is zero or a negative value, then no positive benefit has been demonstrated and no tax clawback adjustment is applicable. In this case, the value of TGIE for Regulatory Year t-2 will be determined to be zero.*
Chapter 8	**Minor**	

Table 8.2 should read:

Regulatory Year t-2 during which activity takes place	**Revised SMAE value for Regulatory Year 2022/23 ~~t-2~~ determined by**	**Reflected in value of MOD for Regulatory Year**

-	30 Nov 3021	2022/23
Chapter 9 Paragraph 9.16	**Minor**	Should read: *9.16 In accordance with CRC 3G, the Authority will determine the relevant adjustments to the licensee's levels of allowed expenditure with respect to proposals made by the licensee within four months of the close of each of the application windows referred to in paragraph 9.9 – ie by 30 September 2020~~19~~ unless the timetable is extended by the Authority in the circumstances and to the extent prescribed in CRC 3G. The determination of relevant adjustments will be made in accordance with the provisions of CRC 3G and this chapter.*
Paragraph 9.18	**Minor**	should read: *9.18 If the Authority has not determined a relevant adjustment in relation to a proposal duly made by the licensee in respect of Load Related Expenditure ~~Specified Street Works Costs~~ within the relevant time limit prescribed by CRC 3G, and the proposal has not been withdrawn, then the relevant adjustment, insofar as it relates to a revision to allowed expenditure levels and LRRC values for the licensee for the Regulatory Years specified in the proposals, will be deemed to have been made.*
Chapter 10 Paragraph 10.6 (and similarly 6.10 and 11.10) states that:	***Substantive*** *10.6 Functionality contained in the PCFM means that the VAA value (as revised) for each Regulatory Year is treated as both the allowed expenditure amount and the actual expenditure amount on Visual Amenity Projects for the Regulatory Year concerned. This has the effect of making eligible expenditure on Visual Amenity Projects neutral for the purpose of the Totex Incentive Mechanism (see chapter 6).*	This is not accurate; functionality in the PCFM sets the allowance for Visual Amenity and Worst Served Customer to equal actual eligible VAA and WSCC expenditure. However, actual expenditure on Visual Amenity and Worst Served Customer will need to be included in the PCFM variable values as part of actual reported Totex.