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Date: 10 July 2014

Dear Colleagues,

**Response to Distribution Network Operators' request for relief from the penalty interest, as a consequence of under/over recovery relating to DPCR4 losses incentive mechanism**

In our recent decision on the DPCR4 losses close-out, we indicated we would consider applications from Distribution Network Operators (DNOs) in relation to any adverse impact or penalty as a result of the effect of the restatement of losses data or the anticipation of the residual losses incentive (PPL values) on allowed revenue under/over recovery positions.<sup>1</sup>

In response, Western Power Distribution (WPD), SP Energy Networks (SPEN) and UK Power Networks (UKPN) have made applications to us<sup>2</sup>, for relief from the penalty interest rate ( $PR_t$ ) in CRC14 (Distribution Charges: supplementary restrictions).

Subject to completion of the steps below, we are minded to provide WPD, SPEN and UKPN with relief from the penalty interest rate ( $PR_t$ ). Please note, however, the decision to issue and approve any direction changing  $PR_t$  is still subject to consultation involving the steps set out below.

*Our approach*

To provide relief from  $PR_t$  in relation to the losses incentive payments for Regulatory Years 2012/13 and 2013/14, we intend to modify CRC 14 to allow us to direct alternative  $PR_t$  values. This is broadly consistent with the approach we took for Electricity North West Ltd (ENWL) in 2013, following a similar request for relief from  $PR_t$ .<sup>3</sup>

We note that WPD, SPEN and UKPN are due to submit revenue reporting returns to us on 31 July and should continue to use the current revenue reporting template (ie no amendments to the  $PR_t$  value(s)). Then, on the basis that both the licence modification for CRC 14 and subsequent direction

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<sup>1</sup> <https://www.ofgem.gov.uk/ofgem-publications/86757/decisiononclosingoutdpcr4lossesmechanism-mar-14.pdf>

<sup>2</sup> References to the "Authority", "Ofgem", "we" and "our" are used interchangeably in this document. The Authority refers to GEMA, the Gas and Electricity Markets Authority. The Office of Gas and Electricity Markets (Ofgem) supports GEMA in its day to day work.

<sup>3</sup> <https://www.ofgem.gov.uk/publications-and-updates/direction-issued-gas-and-electricity-markets-authority-electricity-north-west-ltd-under-paragraph-14.2b-special-condition-crc-14-distribution-charges-supplementary-restrictions-its-electricity-distribution-licence>

are approved (see the steps set out below), we will change the  $PR_t$  value(s) in the completed revenue reporting returns for WPD, SPEN and UKPN to 1.5% for the appropriate Regulatory Years. This change will then adjust their 2015/16 allowed revenue.

*Next steps and possible timing*

- July: Issue statutory consultation to change CRC 14 to provide us with the ability to change  $PR_t$  through a direction.
- July/August: Issue consultation setting out the reasons why we are minded to direct an alternative value of  $PR_t$ .<sup>4</sup>
- September: Issue decision notice on the changes to CRC 14 (subject to consultation).
- November: Changes to licence comes into effect and we issue a direction to change  $PR_t$  (subject to consultation).

*Approach to under/over recovery in Regulatory Year 2014/15*

Under the new CRC2A (Restriction of Allowed Distribution Network Revenue) for RIIO-ED1, which comes into effect on 1 April 2015, DNOs will be able to apply for relief from  $PR_t$  for Regulatory Year 2014/15. We would expect any applications for relief for Regulatory Year 2014/15 to be made next year.

Should you wish to discuss the issues raised in this letter, please contact Tom Mackenzie at [thomas.mackenzie@ofgem.gov.uk](mailto:thomas.mackenzie@ofgem.gov.uk) or on 020 7901 7406.

Yours faithfully,



**Dora Guzeleva**  
**Head of Networks Policy: Local Grids**

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<sup>4</sup> We expect to publish the relevant DNOs' reasoned applications alongside our consultation.