



SP ENERGY NETWORKS

Regulation & Commercial

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Your ref

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Date

14 May 2014

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Dear Ms Freund

Application for relief from the consequences of under/over recovery relating to the DPCR4 losses incentive mechanism

Thank you for your email dated 8th May reminding us to make an application requesting relief from the consequences of under/over recovery relating to Ofgem's decision on 21st March 2014 on the DPCR4 losses incentive mechanism – Decision on restatement of 2009-10 data and closing out the DPCR4 losses incentive mechanism ("Ofgem's DPCR4 Losses Decision"). This application for relief relates to our licensees SP Distribution plc ("SPD") and SP Manweb plc ("SPM").

This application for relief relates to the decision in paragraph 2.183 of Ofgem's DPCR4 Losses Decision which states: "We stand by our previous statement that any adverse impact or penalty as a result of the restatement of data or the anticipation of PPL values on DNO's under/over recovery position will be dealt with on a case by case basis." This decision is further explained in the "reasons for our decisions" section, paragraphs 2.191 to 2.202, of Ofgem's DPCR4 Losses Decision.

Our approach to dealing with the potential PPL residual distribution losses incentive values

2011/12 charges

In October 2010 we considered the allowed revenues that we could collect in 2011/12 in order to inform our charges. The settlements data that we had received at that time for 2009/10 suggested that our estimates of units distributed in 2009/10 (the year to be used for determining PPL) as reflected in the July 2010 revenue return were overstated and that we would be facing a larger penalty under the DPCR4 losses incentive than that already accrued to the end of 2009/10. We subsequently revised our view for final charges in January 2011 as shown in the following table.

DPCR4 Losses penalty (£m)	Estimated at January 2011	Accrued to end of 2009/10	Variance
SPD	-130.0	-53.6	-76.4
SPM	-99.1	-37.3	-61.8

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In anticipation of Ofgem's November 2012 PPL decision we decided to voluntarily under recover revenues in 2011/12 to reflect the variance above with the intention of avoiding volatility in charges for customers over the following 3 years. Our revision to allowed revenues in 2011/12 for charging is shown in the following table.

Allowed revenues 2011/12 £m	SPD	SPM
Allowed revenue pre losses	361.6	327.9
Losses penalty	-14.5	-25.9
Adjusted allowed revenue	347.1	302.0

2012/13 to 2014/15 charges

During 2011/12 Ofgem initiated their consultations into the 2009/10 losses data which ultimately resulted in the removal of manifest errors in the 2009/10 underlying data and Ofgem's DPCR4 Losses Decision. As a result it became clear to us that our ultimate losses penalty was unlikely to be as high as was indicated in January 2011. This resulted in the following adjustments in respect of losses for 2012/13 to 2014/15.

Losses Adjustments £m	2012/13	2013/14	2014/15
SPD	8.0	8.0	4.9
SPM	6.0	6.0	10.0

We initially signaled in August 2011 the intended adjustments to stakeholders as part of the quarterly stakeholder engagement meeting to review our 5 year revenue forecasts and maintained the levels indicated for 2012/13 and 2013/14. In our February 2013 5 year forecast we revised the 2014/15 estimate to the values above when it became clearer what the likely outturn would be. This approach since August 2011 is consistent with suppliers wish that we did not revise our forecasts.

Impact on clawback term

The following two tables show the components of the relevant July revenue returns up to the end of 2012/13 and the resulting impact on 2013/14 allowed revenues of the clawback term.

SPD Clawback £m	2011/12	2012/13	2013/14
Regulated revenue	345.71	365.04	
Allowed revenue	360.13	371.81	
Over/(Under) Recovery	-14.42	-6.77	
Over/(Under) Recovery %	-4.00%	-1.82%	
Interest rate (I _t)	0.50%	0.50%	0.50%
Interest rate adjustment (P _{Rt})	0.00%	1.50%	
Total interest rate applied to over/(under) recovery	0.50%	2.00%	
Interest	-0.07	-0.14	
Correction factor applied in following year		-14.49	-6.91
Interest rate adjustment if not exceeding 3% threshold	1.50%	1.50%	
Total interest rate applied to over/(under) recovery	2.00%	2.00%	
Adjusted Interest	-0.29	-0.14	
Adjusted Correction factor applied in following year		-14.71	-7.13
Variance that would result in 2014/15			-0.22

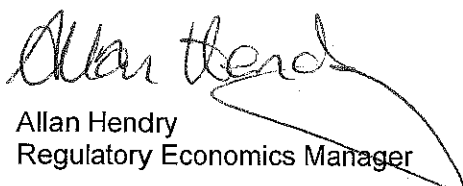
SPM Clawback £m	2011/12	2012/13	2013/14
Regulated revenue	300.23	349.80	
Allowed revenue	325.68	361.15	
Over/(Under) Recovery	-25.45	-11.35	
Over/(Under) Recovery %	-7.80%	-3.14%	
Interest rate (It)	0.50%	0.50%	
Interest rate adjustment (PRt)	0.00%	0.00%	
Total interest rate applied to over/(under) recovery	0.50%	0.50%	
Interest	-0.13	-0.06	
Correction factor applied in following year		-25.58	-11.41
Interest rate adjustment if not exceeding 3% threshold	1.50%	1.50%	
Total interest rate applied to over/(under) recovery	2.00%	2.00%	
Adjusted Interest	-0.51	-0.14	
Adjusted Correction factor applied in following year		-25.96	-11.96
Variance that would result in 2014/15			-0.55

As can be seen from the above tables our decision to try to avoid volatility in charges for customers by making an early PPL adjustment in 2011/12 resulted in the under recovery (almost wholly due to the voluntary PPL adjustment) in 2011/12 (and 2012/13 for SPM) being above the 3% threshold for applying the interest rate adjustment of 1.5% as set out in our Licence in paragraph 14.2 (b) of Condition CRC 14 (Distribution Charges: supplementary restrictions). If the 1.5% interest rate adjustment was applied to the 2011/12 and 2012/13 under recoveries then our revenues in 2014/15 would be higher by £0.77m (SPD £0.22m; and SPM £0.55m).

Our application

Please consider this application to increase the allowed revenues for SPD and SPM by £0.22m and £0.55m respectively in 2014/15 to reflect a one-off adjustment in respect of the clawback term in earlier years relating to the restricted interest rate adjustment as a result of the under recovery exceeding the 3% threshold set out in our Licence in paragraph 14.2 (b) of Condition CRC 14 (Distribution Charges: supplementary restrictions).

Yours sincerely



Allan Hendry
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