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Dear Western Power Distribution,

Updates under CRC 4C. Price control update provisions for WPD and decision on WPD's Network Innovation Allowance

Special condition 4C of the licence for the four DNOs owned by Western Power Distribution provides for the update of WPD's RIIO-ED1 settlement for specific elements.

We concluded the price control of WPD early, (fast-track) based on the high quality of its business plan and the value it provided to consumers. We issued the licence conditions for WPD in May 2014.¹

We recognised in our decision to fast-track WPD² that there were some elements that had yet to be finalised, were due to be updated, or could be dependent on the determinations for the remaining DNOs. Licence condition CRC 4C of WPD's licence enables us to make these updates.

We will consult on a direction to make the CRC 4C updates in January 2015. We welcome any initial views on the proposals in this letter.

The categories of update are:

- financial items that are determined separately to the price control review process
 - an updated forecast for the cost of debt, which is based on an index
 - RAV additions for 2013-14
 - allowances for recovery of pension deficit, which we included as a forecast in WPD's licence, but set in the triennial pension reasonableness review which concluded in November 2014.³
 - tax pool balances, to take account of totex expenditure in 2013-14.
- such adjustments, if any, to ensure that, taken in the round, the DNOs do not suffer material financial detriment from being fast-tracked rather than slow-tracked.

¹ <https://www.ofgem.gov.uk/publications-and-updates/riio-ed1-modifications-special-conditions-electricity-distribution-licences-held-four-licensees-owned-western-power-distribution-plc-wpd>

² <https://www.ofgem.gov.uk/publications-and-updates/decision-fast-track-western-power-distribution>

³ <https://www.ofgem.gov.uk/publications-and-updates/2014-pensions-reasonableness-review> Network companies, including DNOs, have defined benefit pension schemes which were in place before the gas and electricity privatisations in the 1980s and early 1990s. These schemes are all currently in deficit. They have all been closed to new members. We carry out a review of pensions deficit funding every three years following actuarial valuations prepared on behalf of the schemes' trustees. We true-up for the deficit funding amounts companies actually pay to ensure they cannot profit from these revenue allowances.

In the Authority's reasonable opinion, taken in the round, WPD has not suffered material financial detriment from having its determination set at fast-track rather than slow-track. We will consult on this in the direction in January 2015.

The updates we will propose to make are in the table below. All amounts are in 2012-13 prices and are total across RIIO-ED1. We do not plan to update tax pool balances at this time. Tax pool balances as at the end of 2014-15 will be updated in due course as a legacy adjustment through the RIIO-ED1 annual iteration process.

WPD DNO ⁴	Cost of debt updated forecast		RAV additions for 2013-14 (£m)		Pension deficit (£m)		Impact on opening base revenue (£m)	
	previous	updated	previous	updated	previous	updated	previous	updated
WMID	2.60%	2.55%	233.7	250.6	165.7	260.6	3,195.8	3,298.0
EMID			215.5	249.8	163.3	254.8	3,197.3	3,309.1
SWALES			87.7	99.1	172.9	203.4	1,645.5	1,682.1
SWEST			134.4	143.3	281.3	304.8	2,375.7	2,402.3

Our adjustments will not affect the 2015-16 opening base revenue allowances, but will be applied from 2016-17 onwards. We will reprofile WPD's opening base revenue allowances in the light of these updates.

As per CRC 4C we will reflect these updates in the ED1 Price Control Financial Instruments (comprising the ED1 Price Control Financial Model, PFCM, and the ED1 Price Control Financial Handbook); and bring the detail of the common content of the ED1 Price Control Financial Instruments in line with that for the other DNOs.

Network Innovation Allowance (NIA) decision

The NIA is a use-it-or-lose-it allowance that each DNO receives as part of its price control settlement to fund small-scale innovative projects. The value of the NIA is between 0.5% and 1% of base revenues. The amount awarded to each DNO depends on how well the DNO demonstrated, in its innovation strategy, that it has a well thought through plan to focus its innovation efforts over the price control period. DNOs received 0.5% of base revenue unless they provided a reasonable justification that a larger NIA will deliver additional value for consumers. They will be able to use the allowance to fund a maximum of 90% of qualifying expenditure.

In February 2014 we published our provisional NIA for each of the DNOs.⁵ The values were provisional because, as explained in our strategy decision, all DNOs (including fast-track companies) would have the opportunity to resubmit their innovation strategies in March. WPD's fast-track licence included this provision NIA.

All DNOs submitted amended innovation strategies. We consulted on our assessment of the resubmitted strategies and our proposed NIA for all DNOs in July 2014.⁶

In our fast-track assessment of the innovation strategies we asked WPD to submit an improved innovation strategy, even though it requested the default NIA. This is because it fulfilled only three of the minimum requirements. WPD subsequently submitted a revised innovation strategy, but still requested an NIA of 0.5% of base revenue per year.

In our July assessment, we thought WPD could have potentially received a higher NIA if it had requested. But we concluded that we could only award the allowance WPD asked for.

⁴ Western Power Distribution: West Midlands; Western Power Distribution: East Midlands; Western Power Distribution: South Wales; Western Power Distribution: South West

⁵ <https://www.ofgem.gov.uk/publications-and-updates/provisional-network-innovation-allowance-distribution-network-operators>

⁶ <https://www.ofgem.gov.uk/ofgem-publications/89066/assessmentoftheinnovationstrategies.pdf>

In responses⁷ some stakeholders disagreed with this, and thought DNOs should have received higher NIAs where their innovation strategy merited it. Our conclusion is that the DNOs consulted their stakeholders and sought views on their priorities and willingness to pay for innovation. If a DNO thinks the allowance it has requested will allow it to deliver the learning and outputs it requires, then we do not think it appropriate to provide a larger allowance.

Our decision is that we will not change the NIA in WPD's licences. It remains at 0.5% of base revenue per year, for each of WPD's four DNOs.

Yours sincerely,



Maxine Frerk
Senior Partner, SG&G - Distribution

⁷ summarised in the final determinations overview – <https://www.ofgem.gov.uk/ofgem-publications/91564/riio-ed1finaldeterminationoverview.pdf>