

DNOs, consumers and their
representatives, and other
interested parties

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Dear Colleagues

Open letter consultation on the application from SP Manweb plc (SPMW) for relief from the penalty interest, as a consequence of under recovery relating to the close out of the DPCR4 losses incentive mechanism

1. In our¹ recent decision on closing out the DPCR4 losses incentive mechanism (published 21 March 2014)², we indicated that 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.³ This is to prevent DNOs being unfairly penalised for the under/over recovery of revenue related to the Authority's decisions not to activate the Distribution Losses Incentive Mechanism for DPCR5 (published 16 November 2012)⁴ and the decision on closing out the DPCR4 losses incentive mechanism.

Background and applications

2. Where the actual amount of revenue a DNO collects through use of system charges in any Regulatory Year is higher or lower than its price control allowed revenue for that year, the difference is carried forward as an adjustment to its allowed revenue for the following Regulatory Year.
3. Under special licence condition CRC 14 (Distribution Charges: supplementary restrictions), if a DNO's actual revenue is less than 97 per cent of allowed revenue, the under recovery is uplifted by the Bank of England Base rate when brought forward, and the supplementary penalty interest rate adjustment (the PR_t term) is set to zero.⁵ If a DNO's actual revenue collected is not less than 97 per cent of allowed revenue and not more than 103 per cent of allowed revenue, PR_t equals 1.5 per cent.
4. Under CRC 14 we are able to set an alternative PR_t value by a direction. In October 2014 we directed an alternative PR_t value for SPMW for the affected Regulatory Years⁶ 2011/12 and 2012/13. This followed an application from SPMW providing evidence that its anticipation of PPL values had led to its actual revenues collected being less than 97 per cent of its allowed revenue in these Regulatory Years.⁷

¹The terms "Ofgem", "the Authority", "we" and "us" are used interchangeably in this document.

²<https://www.ofgem.gov.uk/ofgem-publications/86757/decisiononclosingoutdpcr4lossesmechanism-mar-14.pdf>

³Paragraph 2.183

⁴<https://www.ofgem.gov.uk/ofgem-publications/45566/1adecisionlossesdpcr5161112.pdf>

⁵Conversely, if a DNO's actual revenue is greater than 103 per cent of allowed revenue, PR_t is set to 3 per cent. This represents a penalty for the DNO, because a smaller under or over recovery would attract a PR_t value of 1.5 per cent.

⁶The affected Regulatory Year is the Regulatory Year that the actual under/over recovery took place.

⁷<https://www.ofgem.gov.uk/publications-and-updates/direction-under-special-condition-crc-14-electricity-distribution-licence-change-penalty-interest-rate>

5. For the same reason, SPMW has now made a further application to us requesting relief from the PR_t value of zero for the affected Regulatory Year 2013/14. This application has been published as a subsidiary document to this consultation.
6. Before issuing a direction under CRC 14, we seek views on our minded-to position to accept SPMW's application and on the PR_t value for SPMW's affected Regulatory Year 2013/14.

Our minded-to position

7. We are disappointed that SPMW did not identify and make the application for the affected Regulatory Year 2013/14 at the time of its request for relief for the affected Regulatory Years 2011/12 and 2012/13. Based on the application, however, we are satisfied that, in relation to the losses incentive values, SPMW's decision to under recover allowed revenue was justified. We are also satisfied that its treatment of the anticipated PPL values caused the PR_t value with respect to the affected Regulatory Year 2013/14 to be zero. Without the PPL value, SPMW would have only marginally over recovered relative to its allowed revenue and received a PR_t value of 1.5 per cent.
8. Therefore, in relation to the losses incentive values, we are minded to provide SPMW with relief from the PR_t of zero by directing a PR_t value of 1.5 per cent with respect to the affected Regulatory Year 2013/14. This change will lead to an expected addition to SPMW's allowed revenue of £0.18m.

Responding to this consultation and further information

9. We are seeking stakeholders' views on our minded-to position outlined in this letter. Responses should be sent to the above address for the attention of Tom Mackenzie, Distribution Policy or emailed to thomas.mackenzie@ofgem.gov.uk by 10 February 2015. We consider that a four week consultation period is sufficient because of the limited scope of this consultation.
10. Subject to the responses to this consultation, we will then look to issue a Direction to adjust PR_t for SPMW for the affected Regulatory Year 2013/14.

Yours faithfully,



Dora Guzeleva
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