

Natasha Richardson
Regulatory Compliance Manager
Western Power Distribution
Avonbank
Feeder Road
Bristol
BS2 0TB

Direct Dial: 020 3263 2782
Email: judith.ross@ofgem.gov.uk

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Dear Natasha,

Application for adjustment to Charge Restriction Condition 8 'IQt' amount in respect of 2011-12 performance in relation to the Low Voltage Network Templates Project

This letter sets out our¹ decision to approve Western Power Distribution - South Wales's (WPD) application, and the reasons for our decision.

Background

On 2 March 2011 we issued our decision² on the impact of the Interruptions Incentive Scheme (IIS) on Second Tier Low Carbon Networks (LCN) Fund projects. In this letter we decided that second tier LCN Fund projects should be protected, through the Discretionary Funding Mechanism, from IIS penalties. At the same time, in order to maintain incentives to minimise the interruptions associated with these projects, we said that this protection would be contingent upon the licensee:

- demonstrating to us that these interruptions could not be reasonably avoided or mitigated, and
- providing us with a detailed plan of how customers will be informed of the interruptions to their service and how their needs will be handled (including how vulnerable customers will be treated).

The IIS Scheme

The IIS incentivises licensees to reduce the impact of supply interruptions by exposing them to rewards and penalties for their interruptions performance against set limits. These limits recognise the fact that supply will be interrupted on occasions as part of normal operation. If licensees exceed them they are penalised; if they outperform they are rewarded. The penalties and rewards are funded by adjustments to the allowed revenue licensees can recover from their customers. This helps to ensure that the price customers pay reflects the quality of service they receive from the relevant distributor.

¹ The terms "the Authority", "Ofgem", "we", "us" and "our" are used interchangeably in this letter. The Authority is the gas and electricity markets authority. Ofgem is the office of the authority.

² <https://www.ofgem.gov.uk/publications-and-updates/decision-impact-interruptions-incentive-scheme-second-tier-low-carbon-networks-fund-projects>

On 5 March 2011 we wrote to your Company Secretary. In our letter we noted that we would provide protection to WPD for up to 115,173 customer interruptions (CIs) and up to 15,834,640 customer minutes lost (CMLs). This corresponds to a maximum of £1.6m of financial protection, plus any loss of return due to the timing difference between when penalties are incurred and when compensation is provided.

We said that in order to apply for funds from the Discretionary Funding Mechanism to cover penalties incurred or loss of revenues earned under the IIS for the identified activities, you should submit a written request at the end of the project alongside any application to receive a Second Tier Successful Delivery Reward. We recognised that this would mean a time lag between incurring penalties and receiving compensation. Consequently, we allowed you to include any loss of return caused by this time difference within your request for compensation. We specified that the calculation of this adjustment should be based on the weighted average cost of capital (WACC) outlined in the electricity distribution price control review 5 (DPRC5) – 4.7 per cent.

WPD's application

On 31 March you wrote to us seeking £1,685,925 and provided supporting documentation illustrating the level of protection being sought and how you had minimised number and duration of interruptions. In this supporting documentation you noted that you had incurred the following:

	Ofgem maximum allowed level of protection	Actual level as submitted April 2012 IIS QOS Interruptions return	% of maximum allowed level of protection
Customer Interruptions	115,173	72,384	62.8%
Customer Minutes Lost	15,834,640	12,589,245	79.5%

We have considered the application, the issues that it raised, and your answers to the questions we have asked.

During that process, it became clear your original application was for the wrong amount. The original amount requested did not include a correctly calculated time adjustment.

The final adjustment you have requested is £1,704,686, to take into account the time between WPD's incurring penalties and receiving compensation.

Our decision

In making our decision we have considered the final level of funding requested, whether WPD developed a clear plan for communicating with customers, and whether WPD did all it could to minimise the number and length of any interruptions.

- The level of CIs and CMLs covered by the application for funding falls within the maximum level we set out in our letter of 5 March 2011, and the amount of funding requested correctly takes into account the time between the interruptions and your request.
- On 31 March 2011 we approved WPD's customer engagement plan. This document explained how WPD would engage with customers in all aspects of the project including on the subject of interruptions.
- We have reviewed technical information we received alongside your application. We are confident that there are no further steps WPD could have taken to reduce the number and duration of interruptions.


We therefore approve the request for £1,704,686 of funding we have received in line with the comfort letter we sent to WPD on 5 April 2011.

Next steps

We will issue a funding direction. This will specify the amount of money distributors will be allowed to recover from their customers over the next regulatory year to fund the recovery of funds under the Discretionary Reward Scheme. The funding direction will require those funds to be transferred to the relevant licensees including WPD. We will issue the funding direction in time for distributors to prepare their indicative use of system tariffs at the end of December 2015.

If you have any questions on this letter, please contact Neil Copeland on 020 7901 7193 or by email at Neil.Copeland@ofgem.gov.uk.

Yours sincerely,



Judith Ross

Head of Network Regulation Policy, Smarter Grids and Governance

Signed on behalf of the Authority and authorised for that purpose