

DNO Under/Over Recovery Impact on Cost of Capital

A DNO member of the DCP 178 Working Group has expressed concerns that DCP 178 could have an impact on the cost of capital for DNOs. This is primarily due to the lagging of incentive revenue within RIIO-ED1 as specified within the Ofgem decision on charging volatility which will not become available until year t+1.

This would be as a result of the DNO calculating their charges for year t+2 in year t however, the recovery for year t would not be finalised and as a result would not be included in charge setting until year t+3. As a result should there be 3 mild winters a DNO could under-recover in each of these 3 years leading to a substantial shortfall in allowed revenue across this period, which could also have an impact on the cost of capital for some DNOs.

The table below provides an illustrative impact across the 5 year period

	Year t	Year t + 1	Year t + 2	Year t + 3	Year t + 4
Revenue used for pricing	400	400	400	420	420
Actual incentives less forecast in pricing	10	10	10	10	10
Actual under/(over) recovery	10	10	10	10	10
Shortfall in allowed revenue	20	20	20	20	20
Cumulative shortfall	20	40	60	60	60