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Energywatch response to Ofgem's Electricity Distribution Price Control Review Initial Consultation Document

Energywatch welcomes the opportunity to respond to this consultation. This document is not confidential and can be published on the Ofgem website.

This response sets out a series of general points that should underpin Ofgem's approach to this review, before providing responses to the specific issues raised in the document.

Consumers expect the distribution network operators (DNOs) to deliver safe, secure and reliable electricity supplies in an effective manner that is efficient, co-ordinated and economical

The fundamental question that the DNOs and Ofgem should be answering as they undertake this review is "why is this the right approach for consumers?" In some cases, the answer will be straightforward, such as when an asset is needed to establish a new connection, but in many cases, the answer will involve the DNO making a judgement about the best course for the future, such as planning asset replacements to maintain security of supply.

The package of measures from this review should stimulate a shift in mindset by DNOs. DNOs need to move away from a mindset driven by asset management considerations to one of providing a service to consumers and of facilitating the country's achievement of wider objectives. DNOs need to be able to justify their actions not only through the price control process, but also to stakeholders on an ongoing basis.

This involves the DNOs becoming more proactive; e.g. identifying preferred locations for the connection and contribution of distributed generation; maintaining dialogues with consumers and other stakeholders about how to develop the network; and increasing the amount of disaggregated information available to consumers; e.g. about network performance.

There is an assumption that DNOs are expected to be invisible as far as consumers are concerned. This assumption is unhelpful and needs to be dropped. It is untrue now, as consumers have to deal with DNOs when they are seeking a connection or

an alteration to supply and when there are interruptions to supply. The impact of losing supply is much deeper than the disruption during the time of the outage. Even transient interruptions can lead to equipment with timers needing to be reset and equipment damaged by surge currents needing to be replaced. Longer interruptions can lead to food perishing, additional fire risks if candles are used for lighting and in cold weather the exacerbation of chronic health conditions.

The visibility of the DNOs should also be expected to increase as networks evolve to meet future environmental and service challenges, or are required to do so. Distribution networks will have a contribution to make if the country is to achieve the 20% aspiration for renewable generation by 2020 and the 60% target reduction in carbon dioxide emissions by 2050. The advent of zero carbon homes could result in equivalent of 2GW per year of distributed generation coming onto distribution networks from 2016. For the first target, there will only be one more opportunity to change the incentives before the target will have to be delivered. Early in this process, a policy decision needs to be informed and then made about whether incremental changes to incentives will be sufficient to meet government targets or whether a more radical approach is required.

Another change that is required is to look at each network both as a whole and at a disaggregated level. This happens to a limited extent already with the Quality of Supply reports. However, worst served consumers and developers of distributed generation will not be well served if the analysis feeding this price control only looks at the averages and aggregates across the whole network.

Ofgem needs to consider whether issues need solutions that work at a national, regional or local level. Some issues such as climate change are national and relevant to all network operators. In these cases, common frameworks are needed and the ENA may have a role in facilitating solutions across and between DNOs. Some issues will be region specific, where the DNO will be the focus for implementing the solution (e.g. improving from sub-standard performance), while others will be relevant for just parts of a DNO's network, such as the impact of distributed generation.

Whatever the conclusions of this review, the licence needs to set out a robust set of obligations for the licensee, irrespective of how the obligations are to be delivered. Ofgem needs to confirm that the licence remains effective in the light of recent changes in DNO ownership structure. Ofgem need to ensure that each DNO delivers a high quality of service that is geared to the needs and expectations of its consumers. There can be no room for special pleading on the basis of the business model employed or other particular characteristics resulting from management decisions, for example on the level of gearing. Ofgem should also review the incentives so that one organisational form does not have particular benefits that are not available to other business structures; for example, the potential for capitalising outsourcing costs.

The DNOs should be exposed to the same incentives as other businesses, for example from the tax regime or carbon markets. Energywatch does not favour the use of reopeners, such as debt triggers or indexation, and would only support their

use in extreme circumstances. We would expect the price control to place a strong set of incentives on DNOs to manage all aspects of their cost base and services.

We also believe that this review provides an opportunity to influence the development of the following issues:

Smart Metering We believe that this review needs to recognise the potential impact of smart metering and consider whether incentives should be placed on DNOs to encourage its implementation. This technology will bring a host of issues for DNOs and has the potential to significantly change the ways that DNOs operate. Obvious applications include supporting active network management and the development of consumer energy efficiency. The roll out of smart metering can provide much more detailed information on the operation of the network and the validity of the assumptions underpinning charging models. Appropriate deployment could also assist with fault location processes and reduce the length of consumer interruptions. It could also provide a mechanism for defining the applicability of a threshold for worst served consumers and performance against such a standard. It will no longer be acceptable to persist with an assumption that conventional metering is the source of performance data and we urge Ofgem to build the potential for improvements from smart metering into the review.

Charging Structures Current charging arrangements support the development of tariffs by suppliers that include either a fixed charge or a primary block of units that are charged at a higher rate. These regimes provide no price signal to consumers about the amount they are consuming or their environmental impact.

This review should consider how cost information can be made available so that alternative tariff structures can be introduced and existing ones refined. Smart metering can provide a useful source of information for addressing these issues. The current work on charging structures is concentrating on the methodologies to be used. In addition to this, the DNOs need to work on developing the information to be used in those methodologies and the opportunity available from this review should not be missed, particularly given the expectation of greater distributed generation.

Environmental campaigners have argued for the development of rising block tariffs and this review needs to explore the information needed to facilitate these being a charging option for suppliers.

Priority Service Registers The value of the DNOs' Priority Service Registers needs to be enhanced. At present, the DNOs' registers focus on those consumers who are electricity dependent. There should be greater co-ordination with suppliers' PSRs, so that both suppliers and DNOs are more aware of where they are likely to encounter vulnerable consumers.

The first key is capturing the details of consumers who should be on the PSR. As well as co-ordinating with suppliers, DNOs need to utilise the local knowledge they have, so that qualifying consumers are able to benefit from PSR services.

Fuel Poverty DNOs need to be encouraged to make an appropriate contribution

to addressing fuel poverty. The Discretionary Award scheme has started to challenge DNOs to think about vulnerable consumer issues, but further work is necessary so that vulnerable consumers' energy needs can be met more effectively. One possible development would be to give DNOs an incentive to facilitate the development of community heat and power schemes, such as the Stockethill scheme in Aberdeen.

The general themes set out here need to underpin every aspect of this review. We expand on these in our responses to the specific questions you have raised. If you do wish to discuss our response further please do not hesitate to contact me on 0191 2212072.

Yours sincerely

Carole Pitkeathley
Head of Regulatory Affairs

energywatch Replies to Specific Questions Raised in the Consultation Paper

Environment

Question 1: Do you think that evolutionary or revolutionary changes are required to the role of the DNOs to ensure that distribution networks remain fit for purpose?

If the latter, in what specific areas does this apply?

The headline role for DNOs is unchanged and as set out in statute – the efficient, coordinated and economical provision of electricity networks. But in practice we believe that major changes are needed in the ways the DNOs carry out this role, due to the changing environment.

In particular, we believe that a revolutionary change is needed in the mindset of the DNOs from being the managers of assets to being service providers and facilitators of broader objectives such as the achievement of environmental goals. This means that there needs to be a much higher level of engagement between the DNOs and stakeholders about the best way forward, while in many cases having only partial information.

Distribution networks also need to be viewed as composites of smaller networks, rather than as single entities. The increasing prevalence of distributed generation means it will be appropriate to be looking at issues within the network and the differences across parts of a network, rather than looking at the average impact over the network as a whole. This already occurs to a small extent as quality of supply data is published both for each network as a whole and for subsets of each network, but further refinement is needed.

Question 2: Do you think that we have identified the key areas where DNOs can facilitate activities that have a positive impact on the environment?

We agree that DNOs have both direct and indirect impacts on the environment.

We believe that the key areas have been identified, however more attention needs to be paid to electricity losses, and particularly the impact of distance travelled within networks.

Environmental challenges are dynamic. Some commentators say that global warming is accelerating and that the UK may need to move its carbon target to an 80% reduction (or greater) by 2050. The DNOs also need to be factoring the impact of other reviews and legislation into their investment cases and justifications, such as the Pitt Review into Learning the Lessons from the 2007 Floods.

As well as activities with a positive impact on the environment, the DNOs also need to develop plans and justifications to address the adverse impact of the climate in this country. Developing network resilience and making investments to prevent

adverse events need careful consideration, but will be a critical part of the story presented to stakeholders.

Question 3: How do we ensure progress is made on the issues identified with the connection of DG? Should progress be facilitated through a working group or should more formal obligations be developed?

At a headline level, the data in Appendix 9 indicates a dramatic failure and suggests that the current incentive is ineffective and that other incentives or regulations are needed. However, we would like to see further detail in this area before supporting more formal obligations. For example, how much of the lack of progress in meeting the forecasts is down to poor forecasting? How much is due to the delay of individual schemes? What factors have led to these delays? What other reasons are contributing to the non-appearance of distributed generation schemes; e.g. failing to get local residents and planning authorities on board? What volume of DG do the DNOs now anticipate connecting during this price control period and how much, if any, of the forecast capacity is deferred into the next price control period?

We would expect Ofgem to be able to gather sufficient information to provide an informed assessment of the situation in time for the December policy paper. A working group may be a suitable mechanism for completing this task.

Developing a national standard connection agreement and standard process appears to be a sensible step forward and we look forward to hearing more about these arrangements in due course.

Question 4: Do you agree that DNOs should have stronger financial incentives to reduce their carbon footprint? Do you think that we have identified the key areas where it may be possible to do this?

DNOs should be exposed to the same incentives as the rest of the economy for handling of their direct carbon footprint and Ofgem should not distort this incentive through the price control mechanism.

The majority of a DNO's footprint is losses, which are driven by the use of the network. So far, the focus of the work on managing losses has been on the assets that generate the losses and replacing equipment with better performing units. However losses are not only driven by the asset mix that makes up the network, but also by how those assets are used. For example, the closer generation is to demand, the lower the loss. Incentives need to target reducing the losses associated with how the network is used, not just what the network comprises.

Question 5: How can the Long Term Development Statements be made more useful for DG and other users of the network?

Long term development statements can be made more useful by increasing the accessibility of the information, which should also be more disaggregated. It is not sufficient for DNOs to say that information is available on request. Developers should be able to make independent enquiries about the network, rather than having

to channel them through the DNO and wait to see the selected information that the DNO provides. More open access will allow developers to come up with more rounded plans that have explored more options. This should improve DNO efficiency, as there will be less repeat enquiries about the same potential project, enable developers and DNOs to have more detailed discussions sooner about potential developments and enhance coordination of the network, as it should reduce the number of speculative discussions that DNOs need to be involved in.

Published statements should be supplemented by web based tools that allow stakeholders to see asset utilisation and key flows across the network. This approach can also provide a mechanism for the DNO to show how it manages its network under different scenarios and highlight areas where there is the greatest potential for connection of demand and of generation.

DNOs should also be exploring how to link the web application into the connections process. This should increase the ability of developers to specify the connections they will require and to understand the impacts of the potential development on the network, improving the visibility of the reasons behind reinforcement costs.

Question 6: Is the current regulatory framework constraining a DNO's ability to facilitate low/zero carbon technologies and if so, what could be done to address this?

The likelihood of the current regulatory framework constraining a DNO depends on how dramatic the changes in network use are expected to be. If the future changes are likely to be incremental, then the framework is unlikely to provide a significant constraint. However, some of the environmental changes being proposed suggest that more dramatic solutions may be needed and in this case, the framework could be a constraint.

Before solutions can be put forward, DNOs need to provide and justify their assessment of how dramatic the changes in use are going to be. We suggest this should look beyond the next price control period and through to 2020 at least. The LENS project will be a useful input, as it will provide a series of scenarios, but further analysis will be needed to answer this more specific question.

The development of Regional Power Zones has been slower than anticipated at the last review. Opening up this arrangement to business consumers may be of benefit, but we do not support extending the scheme to domestic consumers who may not fully grasp the consequences of being in an area with, for example, a permitted lower security of supply. As only four RPZ schemes are going forward, before widening the approach, we would like to understand why there has been so little take up so far.

Customers

Question 1: Do the current regulatory arrangements deliver the levels of service that customers expect?

Question 2: Is the focus and scope of the current regulatory arrangements correct

and are there any gaps that need to be addressed?

Question 3: Are DNOs customer focused enough or should they be doing more to improve communication with customers?

Worst served consumers

The majority of consumers are well served; i.e. they have no or little problem with security of supply. However, greater emphasis needs to be placed on the issues faced by worst served consumers. Contrary to the comment in Appendix 7 that consumers prefer frequent short power cuts over long, infrequent ones, a regular comment in discussions we have with consumers and stakeholders relates to the nuisance value and disruption that an interruption in supply causes. Our research suggests the opposite – that consumers prefer one long interruption. We look forward to seeing the establishment of a separate performance standard for worst served consumers and to it taking this nuisance factor into account.

We completely agree with the statement that a drawback of the IIS is that it does not provide incentives for DNOs to improve service to consumers who experience below average reliability of supply. Of the options presented in Appendix 7, we favour the third option, creating a threshold to define who the worst-served are and setting targets related to the threshold. We believe the first option is not viable, as it will be difficult for consumers to understand and accept, at the time that they have experienced a power cut, that they are not worst served or that different standards will apply. The second option may be a useful part of the worst served consumer incentive, but is insufficient on its own, as it is too simple an approach to the definition of worst served.

We would expect the threshold and targets to recognise the additional disruption from multiple interruptions. We also expect this standard to recognise that businesses can be on the end of the most troublesome lines and would like this standard to include multi-site consumers, where each premises may have only one interruption a year, but across all the sites, the consumer may have experienced 20 – 30 interruptions in a year. We recognise that these cases are unlikely to be restricted to within one DNO's authorised area and suggest that these claims could be facilitated by the ENA or the consumer's supplier.

A more objective measure of level of service is required than the level that consumers expect, as expectations vary with experience. Further work should be carried out to assess the differences in expectations between consumers who experience few interruptions and those who have experienced several interruptions. This will provide a better measure of the willingness to pay than averages across communities, many of whom have not been sensitised to the impact of an interruption.

Interruptions

We support splitting pre-arranged interruptions into four streams and keeping the targets for pre-arranged interruptions separate from the targets for unplanned interruptions.

However, we believe that the proposal to offer frontier DNOs an allowance in exchange for a tighter target is misplaced. An emphasis in the price control should be to bring the laggards up to the frontier, so that everyone benefits from this level of performance. Focussing on the frontier performers is likely to widen the performance gap that consumers experience. Additionally, this could prove counterproductive for a frontier DNO if doesn't achieve the new performance level. In these circumstances, even though absolute performance will have increased, the performance against target, which is published, will be seen to decrease and consumers may believe they are getting a worse service.

We would suggest that the threshold for exceptional events should focus on managing the underlying performance. The threshold should be reviewed in the light of information about the likely cost of tightening it. However, as well as reviewing the threshold, there needs to be an ongoing incentive on DNOs to ensure that, regardless of whether an event is exceptional or not, the DNOs do the best that can to restore supplies as quickly as possible. We would therefore suggest that these arrangements should include some form of clawback if it comes to light that the DNOs have not provided as good a service as they can in those circumstances.

Guaranteed Standards

Setting the threshold for the Guaranteed Standard for interruptions is a trade off between the inconvenience caused by the outage and the cost of preventing it. We recognise that tightening the standard is likely to incur additional costs and would like to see further information about the size of these costs if the standard were to be tightened to 12 hours or 15 hours.

We are concerned that we cannot yet say there has been an improvement in performance. We appreciate that Ofgem is doing more work on the returns from DNOs; however we are concerned that consumers do not have sufficient up to date information on DNO performance against the standards. This means that consumers that want to engage with their DNO about apparent poor performance do not know whether their situation is an isolated case or part of something wider. We hope that the appropriate information will be available soon that can help consumers assess how effective the DNOs are performing and make appropriate comparisons.

Connections

Consumers do not receive an appropriate level of service when seeking connections or alterations to supply. Complaints are most commonly about quotation accuracy or about delays in completing the connection. We have included a selection of case histories in Annex I to illustrate consumers' experiences. Competition has delivered few improvements, particularly for domestic consumers, and this is an area that needs further regulatory action.

We support the development of the licence condition covering connections performance and expect this to mirror Special Standard Condition 10 of the Gas

Distribution Licence. In addition, to recognise the lack of competition so far, we would favour the inclusion of connection-related costs within the price control, coupled with a revenue driver that would take account of market share lost.

Customer Service Reward Scheme / Complaints

The customer service reward scheme has yielded some benefits, but we are concerned that it does not take account of inconsistencies across the DNOs. We are concerned that the DNOs are not applying the same approaches when assessing what scheme to put forward. In particular, we are concerned that DNOs may be claiming innovative best practice when it has been practiced without fanfare by another DNO for some time. We would like to see greater standardisation applied to this scheme, akin to what was needed for cost assessment five years ago, and support the incorporation of best practice into licence conditions. We also would suggest that the scheme should evolve so that more, smaller awards can be made each year to recognise a range of innovations or improvements.

Following their inclusion in the previous incentive regime, the receipt and handling of complaints became and has remained a high priority for DNOs. Changes within the CEAR require that DNOs are members of an ombudsman scheme and this coupled with the demise of energywatch means that robust, transparent and effective complaint handling by DNOs is even more vital than before. It is essential that Ofgem monitors performance closely in this area and ensures that any areas of consumer detriment are addressed quickly and effectively.

Telephony Incentive Scheme

DNOs need to improve the service they provide when consumers need to contact them. DNOs have an important role that consumers generally do not understand. Most contact will be at times when consumers are stressed, either because of an interruption to supply or difficulties with connections. Customer service is much more than telephony standards, particularly when a significant proportion of calls are not answered by a person.

The purpose of incentives is to change behaviour so that the service consumers receive is improved. The current telephony scheme has little incentive power and should be changed. Current performance is toward the top end of the range, yet the scheme ignores the people who do not get through to a DNO operator. This incentive should be extended to cover unsuccessful call percentages and consumers dealt with by messaging systems. The incentive should be restructured so that there is an incentive to provide a personal response to as many consumers as possible. We would also advocate tightening the current control by removing the small reward that is currently available, increasing the downside should performance fall and incorporating the existing telephony survey into the DNO consumer satisfaction surveys.

The data in Appendix 7 about dissatisfaction with the overall quality of the telephone response highlights communication issues that the DNOs need to address. Much of this dissatisfaction arises from consumers not being able to control the situation.

Implicitly some DNOs are saying the consumer doesn't matter. The industry needs to look at how other sectors handle these situations and the lessons to learn. We are in favour of including the two questions in para. 1.60 of Appendix 7 in the consumer satisfaction work and also in other information requests from time to time.

Determining Performance

We believe that Ofgem should consider the establishment of a Consumer Service Performance Panel that would include stakeholders. The main tasks for this panel would be recommending changes to the performance measures used, the measuring of performance and highlighting best practice. This panel could be the recipient of the Accent surveys and contribute to the Discretionary Award process, but should also be looking much more widely at DNO performance and the service they are providing. If necessary, this group could investigate the consistency of information so that consumers could be assured that valid comparisons can be made.

Question 4: Is DNOs' financial exposure set at the right level and/or do we need to change the emphasis in certain areas?

We believe that DNOs' exposure to Guaranteed Standards payments needs to change. The present arrangements recycle money to the affected consumers from the generality of consumers without placing an incentive on the DNOs to address the issue that caused the failure. The current regime can encourage an "accept and pay out" mentality, including awarding ex gratia payments to avoid published failures, rather than one that seeks to identify root causes of problems and eradicate them. We would like the price control incentives to address this shortcoming.

We support the extension of the Guaranteed Standards to include timescales and compensation levels for restoring complaints. This will bring this part of the electricity and gas regimes into line and simplify the situation for consumers.

We believe that a much greater emphasis needs to be placed on consumers' experiences. This may be achieved through the tailoring of financial exposures, but we would like to see this become a deeper part of the whole review process; e.g. through the incorporation of consumer experiences into the composite variable used for benchmarking.

Question 5: Do you think we have identified the right issues and appropriate areas for development with the existing incentives?

We strongly support the emphasis being put onto the service experienced by worst served consumers. We also support working to improve connections performance and expanding the scope of the telephony incentive.

Networks

Question 1: Have we captured all the key lessons learnt from DPCR4 regarding

cost assessment?

Good progress has been made on the definitions of costs, but it should be remembered that this is not a finite exercise, as there will always be new perspectives and new information coming to light.

In the current economic environment, it will be appropriate to identify how much of any increase relates to higher levels of activity, how much to higher input costs and how much to delivering service improvements.

We also expect the DNOs and Ofgem to be open about how much expenditure paid for under the current control will be delivered during the next price control period. Further, and in the light of the reasons given for the lower levels of capex so far, we would also expect the DNOs to explain how they believe they are going to deliver higher levels of activity, when this has not been achieved so far.

Question 2: Is our approach to cost assessment appropriate?

Question 3: Are there alternative approaches to cost assessment that we should be considering?

Consumers are passive recipients of the charges that arise from the price control reviews. They need to be confident that the prices they are being asked to pay are fair, well understood and represent value for money. An appropriate approach to cost assessment will be explicit about this. Transparency and clarity will assist confidence, as will cost reporting data that is usable, accessible and understandable. Finally, consumers will have greater confidence if cost data can be broken down so that they can see what is required to maintain existing levels of service and what is required for new developments.

We would suggest that Ofgem reviews its approach to cost assessment against these criteria and identify if any changes are required.

Question 4: How might our approach to benchmarking be improved?

The benchmarking approach needs to be more aligned with consumers' experiences. Two of the three components of the composite variable (network length and customer numbers) are input measures that do not relate to the impact that DNOs have on consumers.

Benchmarking that focuses on input variables places leads to arguments about differences in technical conditions between the DNOs' systems. An input based approach sets up "special pleading" arguments and emphasises the nature of the networks and the analysis tool rather than on what effect any of these differences have on consumers' experiences.

Another issue with benchmarking arises from how activities are broken down and then analysed. Breaking down activities and then completing regression analyses may identify the short-term efficiency frontier for that activity, but the most effective long-term service for consumers may be delivered by a DNO who is not at the

current cost frontier. The danger of this increases as 1) input measures are used as the variable, and 2) as the activity is atomised, as factors that hold activities together are lost from the analysis.

DNO assets are long-life assets, so we also expect the benchmarking analysis to be employing long-term tools and techniques, so that issues related to the timing and phasing of expenditure do not distort outcomes. We also believe that Ofgem should be looking to identify separately the improvements that have arisen from reductions in costs, which may not be sustainable, from those that have arisen from improvements in processes, which we would expect DNOs to maintain.

Question 5: Have we captured all the key issues for “networks”?

We believe that network utilisation is a key factor that needs to be understood better. This can impact on consumers in many ways. The costs of connection will depend on reinforcement required. The benefits of distributed generation may depend on local constraints. Network resilience and the duration of network outages may depend on the local ability to reconfigure the network. Voltage adjustment may be more likely in areas of high network utilisation.

Network utilisation should be one of the factors that is standard in asset management appraisals and we believe this should be information that is released to stakeholders so that there is a broader understanding of costs and priorities. Increased knowledge in this area will also facilitate the development of active management techniques where appropriate.

Question 6: Is our building block approach to forecasting appropriate?

The building block approach is worth pursuing, as it can open up discussions about the interactions between the various parts of the DNOs’ operations and can improve and deepen understanding. However, there is a danger that it will lead to an undue focus on the inputs and engineering elements that make up each network at the expense of considering the service that consumers are receiving from each DNO. Consumers need to see and be able to understand how much is required to maintain the status quo and how much expenditure is for improvements.

In addition, we do not believe that each building block can be described discretely with firm boundaries. In the same way that we have talked in the past of trade offs between operating and capital expenditure, there are interactions and trade offs between the blocks. Further work will be needed on defining where costs, inputs and outputs lie under this approach and on understanding the interactions between the blocks.

Question 7: What is the scope for developing additional outputs measures and how can these be incorporated into the price control?

There is significant scope for developing additional outputs measures. While it is easier to measure inputs, we urge Ofgem to fully explore how measures such as consumer minutes lost and numbers of interruptions can be more fully built into the

assessment of the effectiveness, and not just efficiency, of the DNOs. Ofgem should explore how to use these measures in the benchmarking process.

In addition, connections and alterations to supply account for half of the complaints about electricity DNOs received by energywatch. Commonly there are issues with delays in getting quotations or work completed. The Guaranteed Standards provide minimums that should be met, but these should be complemented with an incentive on the effectiveness of connections processes. Annex I includes examples of poor performance gathered from a quick review of recent cases. These cases illustrate the sorts of failings that consumers have to cope with and could form the basis for a connections process incentive.

The Connection Charge Accuracy Challenge scheme has been introduced for the gas DNOs and we believe that this scheme is also needed for the electricity DNOs. We anticipate this would be introduced through a new licence condition.

We are concerned that the arrangements regarding the quality of telephony response offer only a weak incentive to improve performance from current levels. It is necessary to assess the quality of response received, but we understand this does not apply to almost 80% of consumers. Limiting the output assessment to those consumers who managed to speak to an operator gives no incentive for the DNOs to increase the numbers of consumers they speak to. Ofgem's survey also shows that 24% of respondents were dissatisfied with the time it took to get through or were on hold. The output measures need to build in these factors, so that there is an incentive on DNOs to provide quality response to as many people as possible.

Question 8: What is the best way for DNOs to gain stakeholder input to their forecast business plans and how should Ofgem facilitate/incentivise this?

We welcome the emphasis on stakeholder engagement and the news that some DNOs have already indicated they expect that this will become an ongoing process.

DNOs need to do more than just collect a series of stakeholders together and present a limited number of options to them. Effective input means:

- The input comes from informed and engaged stakeholders, from across the full range of consumers. Some of the stakeholders should be “ordinary” members of the public, but the stakeholders also need to include those people who should or who do have regular contact with the DNO and who have some understanding of the issues being considered.
- Stakeholders who have raised issues with DNOs are a start point, but each of these will come from a particular perspective or have a vested interest to promote. The important thing is that, in aggregate, the stakeholders are diverse and cover a wide range of experience and interests.
- Stakeholders are able to provide input that drives the plans and operations of the DNOs.
- The DNOs should employ a range of styles and methods of engagement, such as focus groups, web forums, surveys (both face-to-face and electronic), public events and roadshows. We would also expect the DNOs to undertake these as part of an ongoing process, so that attitudes and

- expectations can be tracked over time.
- DNOs should take responsibility for the stakeholder process and this process should be assessed by Ofgem. Elements to assess include the style of engagement (was debate encouraged or was it just a selection of predetermined options), the diversity of interests canvassed, feedback provided by the DNOs on the stakeholder engagement process and what they learned from it, and the impact of the stakeholder input on the DNO's plans and operations. Ofgem could also ask stakeholders to appraise the process and its impact. The objective of these appraisals would be to improve the level of engagement over time.
 - The Consumer Panel could also have a role to play by providing a source of informed stakeholders that could be part of the engagement process. Alternatively, Ofgem could gather together a group of consumers specifically for this purpose and arrange for them to gain a basic understanding of electricity distribution and the current issues.
 - We support the creation of a challenge group, specifically set up to be a critical friend to the DNOs. This group could be set up and maintained by the Energy Networks Association, rather than by Ofgem, to challenge the plans and justifications DNOs are putting forward, to assess whether there is sufficient interaction with stakeholders and to review how the DNOs have acted on the messages they have received.
 - The process must not be a one-off arrangement for the purposes of this review, but an ongoing arrangement.

The real value from stakeholder input is in improving the DNOs' understanding of consumers' interests and expectations. We believe that stakeholder input should become an integral and ongoing part of DNOs' planning and operations processes. One way to facilitate this would be to add a stakeholder engagement section to the regulatory reporting pack, setting out the engagements that the DNO has arranged during a year and the impact of the stakeholders' input on the DNO's plans and actions.

Assuming the engagements are effective, as time progresses, consumers involved in the stakeholder engagement will become less representative of the general public, as they become sensitised to issues and so respond differently. To address this issue, DNOs may wish to set up a control group that would not directly be party to the engagement process.

Question 9: Is the IQI and capex rolling incentive the best way to ensure realistic forecasts and efficient investment?

Question 10: How might the IQI and capex rolling incentive be improved or what additional measures could supplement them?

The IQI provides an incentive against DNOs overstating the anticipated level of expenditure, but this arrangement has the downside of reinforcing the perception of price control allowances as a budget to be constrained by and does not provide any link to the experiences and aspirations of consumers.

Consumers need to feel that the investment plans are appropriate and adequate and

we would expect the capex programme to be a key part of discussions with stakeholders. Effective dialogue will mean that consumers will fully support the capex programme and believe that the DNO has their interests to the fore. This will provide a valuable additional reference point for assessing the effectiveness of investment plans, complementing the efficiency assessment of Ofgem's consultants.

Question 11: Should we aim to equalise incentives on network investment and business costs and how could this be achieved?

Consumers are looking for DNOs to carry out the appropriate mix of activities that will provide an effective service. The DNOs should not be driven by regulatory rules towards acting one way or another, so Ofgem should be aiming to equalise incentives on network investment and business costs. To this end, we would expect a thorough consideration of total factor productivity and how this can be used to incentivise the DNOs.

Question 12: Is the timetable realistic?

We have no comment to make at present.

Financial Issues

Question 1: Should Ofgem use its traditional approach to calculate the cost of capital or should other approaches be considered in order to provide the necessary incentives to invest?

Overall, we understand that the incentives to invest are being reviewed by the RPI at 20 project. However, should alternative approaches to calculating the cost of capital be put forward during the course of this review, Ofgem should consider them. What is vital, however, is that if there is to be any change to the approach, it must be demonstrated that this will be of benefit to consumers.

Question 2: In particular, should measures to protect DNOs from debt market volatility be considered, such as indexation of the cost of debt, or the use of reopeners at "trigger" levels of interest rates?

We do not support measures to protect DNOs from debt market volatility. These approaches are, in effect, reopeners that shift risk from DNOs to consumers. The principle to apply is that the risk should lie with the party best placed to manage the risk. If DNOs are protected from debt market volatility, we believe this will displace the risk on to suppliers, who would add a risk premium, and thence to consumers. If DNOs or others can demonstrate that introducing such a change will unequivocally benefit consumers, we would be happy to hear how this would work.

Question 3: Should Ofgem make financeability adjustments or is this a matter for DNOs once the cost of capital is set?

In principle, as DNOs are businesses with long-term assets, we would expect the cost of capital to be sufficient. Ofgem should not set out with the expectation of

making short-term adjustments for financeability, however if this leads overall to a lower cost of capital, it should be explored

Question 4: Is it appropriate for Ofgem to be making commitments on investment and its financeability over the longer term?

It is appropriate for Ofgem to make commitments that are consistent with its statutory objective to protect the interests of consumers. Any commitments Ofgem makes to companies and investors about investment and its financeability must only be subject to this objective.

Question 5: Should a mechanism for ex-post adjustments for major changes in the tax regime be introduced and, if so, how?

We do not support the introduction of such a mechanism. Changes to the tax regime are introduced across the economy as a whole and it is not appropriate for any such changes, in effect, to be passed directly through to suppliers and consumers. Once again, DNOs will be best placed to manage this risk and it should stay with them.

Question 6: Do respondents support the publication of a fully populated financial model?

Yes. The more information that is available to stakeholders, the better the dialogue and understanding.

Question 7: Should we calculate the DNOs' allowed revenues in a way that creates a smooth revenue profile over the course of the price control period and seek to reflect the level of costs expected in the last year of the control in order to reduce price changes from one control to another?

Smoothing allowed revenues should not be an objective at the outset of the price control process. The first thing that needs to be understood is the likelihood of significant variations in costs through the price control period. Companies will need to justify both why there will be such variations and how they will physically deliver the programmes they are proposing before any discussion of smoothing is appropriate.

Question 8: What factors should we take into account when determining the level of gearing to assume?

We expect Ofgem to consider a company's ability to pay back its debts using measures such as interest cover. We would also expect there to be some stress testing of levels of gearing looking at potential changes in interest rates and revenues, whether through changes in demand or clawbacks under price control arrangements.

The level of gearing should also be viewed in the light of consumers' views on the issue. Debt funding has contributed to lower costs for consumers, however excessive gearing could lead to short term cuts in services that lead to a lower

quality of service over the long run. For example, previous costs pressures led to reduced tree cutting programmes that led to increases in interruptions. Ofgem need to make sure that the provisions of the licence are robust, so that quality of service is not sacrificed, particularly if credit cost pressures increase further.

Question 9: Do respondents agree with the proposed treatment of net debt and gearing in ex post adjustments to tax allowances?

This is another aspect of the control where the key question for Ofgem should be “what is the impact on the consumer?” We expect that if changes are to be proposed in this area, there will be a demonstrable case that consumers will benefit from the change.

Question 10: What are acceptable alternative approaches to calculating RAV additions; and, following recent market transactions, does RAV continue to reflect the underlying enterprise value of the business?

RAV is not an item that should be considered on its own, as it interacts with other elements of the control such as the cost of capital, depreciation policy and incentive mechanisms. Asset values have been one of the fundamental building blocks of the RPI-X regime. Rather than introduce a change at this point, we believe that this is best considered as part of the RPI at 20 project.

Process

Question 1: Do you agree with the range of consultation approaches we intend to use throughout DPCR5?

The range of approaches appears to provide a reasonable mix that should provide a wide range of inputs to the process.

Question 2: Do you believe that we should utilise a consumer orientated challenge group to inform DPCR5?

Yes. See our earlier comments on stakeholder engagement.

Question 4: Are there any other ways in which we should look to consult with interested parties?

In the same way that the DNOs should be engaging with consumers using a variety of styles and methods, Ofgem should consider a range of methods for capturing views. We presume that Ofgem will be contacting the stakeholders that the DNOs have approached as part of how they assess the stakeholder engagement programmes.

Web-based tools will be a useful means for capturing the views of individuals, particularly those who have not been sensitised to issues through other engagements with this review process. Different information will be gathered when using face-to-face mechanisms. Some of these should be structured, such as surveys; however,

Ofgem should also use approaches that enable consumers to make unprompted comments, such as roadshows.

Question 5: Do you agree with our approach to publish specific impact assessments for key "important" decisions?

We agree with the approach, but are not sure how much value the impacts will ultimately be, as each assessment will only be for a part of the DPCR outcome, so may have to be conditional. In these circumstances, being very clear about the assumptions used in the impact assessment will be critical so that consumers and others can understand the basis of the decision.

Question 6: Are there any other key milestones that you believe we should consider for DPCR5?

This is not a specific milestone, however we are aware that the issue of climate change is under ongoing review and that some commentators are arguing that more extreme action may be needed sooner. The DPCR5 process will need to keep an eye on these developments, which could have a significant impact on priorities and timescales for network investment.

ANNEX I Recent Connections Case Histories

Case details

During 2007, the consumer applied, through an agent, to have a new supply installed so they could benefit from a new central heating system. The DNO quoted £5402.65 for the installation.

Energywatch approached the DNO for an explanation and breakdown of the quote, and whilst the DNO was compiling the data, they discovered an 'error' with the quote and promptly re-quoted the job. The 'error' was allegedly down to them quoting against the wrong property and the final quotation came back at £169.20.

The consumer was very concerned at the continuing delay and uncertainty surrounding their requests for a connection to the network for their on-site (embedded) generation. An initial payment of around £100 000 was made in late 2006. While numerous delays were encountered surrounding necessary wayleave agreements, it had been believed that the work would be completed towards the end of 2007 and hence the generation plant had been in place at the site since December of that year. By May 2008 the consumer was still awaiting a firm date for completion of the works paid for. Unexplained delays continue to prevent them realising contribution from their significant capital investment. They are unable to extract power for their own needs, much less the revenue they would expect from sale of surplus capacity. The company estimates that their losses will be around £350,000 for the period they weren't connected.

The company had also found it difficult to obtain their connection agreement from the DN – a document they needed to apply for their ROC.

The project is to provide a new electricity supply from a nearby 11,000 kva overhead line into a large corn store.

From early 2007 for about 12 months the consumers were unsure about the final design of the new corn drying shed and so the electricity demand needed was changing.

On 31 October 2007 indicative prices were sent by the DNO for a 200kva mounted transformer for £14,000 + vat and for a ground transformer with low voltage cables for £36,000 + vat. On 21 December 2007 a quote for a 200 kva pole was received from the DNO for £13,374.04 and on 16 January a cheque for £13,374.04 was sent to the DNO, however it did take several weeks for the DNO to discover that they had received this.

In early February 2008 it was decided that a supply of 1000 kva and a much bigger transformer would need to be installed. On 27 March 2008 an indicative price of £43,477.07 was given for providing a low voltage supply, assuming a ground mounted 1000kva transformer within 20 metres of the 11,000 kva supply. This price excluded any reinforcement works.

After more discussions a quotation was received dated 9 May 2008 of £65,689.55 + vat. For comparison, the consumer obtained an independent quotation from a contractor which equated to only £18,000 and left only £5,000 worth of work to be carried out by the DNO.

On 23rd May the DNO provided a breakdown of their 9 May quote. The consumer wrote back on 30 May accepting a part of that quote which was to supply an HV supply to the new transformer only for £16,507.81.

On 2 June the DNO wrote back saying that as the 30 day period was up the quote had lapsed. It returned the latest cheque for £5,264.18, the acceptance and indemnity form. However from the 9 May until 2 June doesn't equate to 30 days.

The consumer believes that the DNO are overcharging by as much as £40,000 for the work, and they are finding that dealing with the DNO is very difficult.

Case details

The consumer approached energywatch after failing to receive an appropriate quotation from the DNO for a single domestic connection. The property in question already has a supply, however it is only connected to one of the dwellings within the two dwelling property. The proposal from the consumer was to underground all of the cabling and to provide a connection to his dwelling. He does not agree with having to pay for the supply upgrade to other properties in the street that feed from the same supply.

The quotation which he received was for £5825, which was over and above what he expected to pay. The quotation was later reduced by the DNO by some £1300, but the consumer still feels that this is too much for a single connection.

The consumer has been attempting to obtain a new domestic connection since around 2006. energywatch first became involved in July 2006. It was passed to Ofgem toward the end of 2006 for informal technical advice, who replied that the costs appeared to be appropriate for the work envisaged. However, the consumer came back this year to advise that the connection has still not been completed and he has had to stop the DNO from completing the connection as it is going against the original plans.

The original plans indicated that the transformer would be sited within his boundary, allowing him to apply for rebates for up to five years for first & second comers to the connection. As the transformer was sited outside his boundary, he has asked that the DNO provides an agreement honouring this period (as if outside boundary, the claim for first/second comers is considerably less time) and also requesting if he could have unlimited years to claim for first/second comers.

The DNO informed the consumer that he would only need to pay for a proportion of the connection but he has already paid £23,000, the full cost of the connection and it still has not been completed to date. The consumer is extremely frustrated with the length of time and the problems that have arisen.

The consumer was not satisfied that a quotation for the connection of 4 dwellings was accurate. The project comprises the refurbishment of an existing Farmhouse, which is already served by a supply and two new connections for other domestic dwellings.

It was the consumer's understanding that all electricity connections would be available on the open market; however after contacting several independent connections providers, they have found no alternative but to approach their local Distribution Network Owner.

Connection costs originally came to around £9k and after disputing this formally with Ofgem, the costs reduced by around £2k after concerns were raised regarding certain elements of the DNO's pricing methodology.

The consumer has been trying to arrange for her existing supply to be split between her garden nursery business and domestic property since April 2007. There had been issues with the cost and the fact that the DNO was unwilling to arrange for a site visit and to explain the need to upgrade the transformer.

The consumer had been receiving various quotations for connection fluctuating from £4k up to £18k and the fact that the DNO would not attend a site visit only hampered the consumer's attempts to get a connection. For nearly 12 months, the consumer remained without an adequate connection.

