

Maxine Frerk
Interim Senior Partner, Smarter Grids and Governance: Distribution
Ofgem
9 Millbank
London
SW1P 3GE

3 November 2014

Dear Maxine

Regional Costs Factors

We would like to take the opportunity to re-iterate UK Power Networks' position on Ofgem's approach to regional costs and their application to our three distribution licence holding companies: Eastern Power Networks plc, London Power Networks plc, and South Eastern Power Networks plc in the RIIO-ED1 final determinations.

UK Power Networks experiences significant additional costs in the south east of the UK arising from higher labour costs, contractor costs and other network and environmental factors. We have provided a full and detailed justification of these impacts and their consequences in a specific annex to our Business Plan (Annex 13a: Regional Cost Justification).

We have supported Ofgem's independent approach to determining regional adjustments as part of the regional costs adjustments made in the benchmarking process for Fast Track and the Draft Determination. We consider what you have done to date to be robust and to be an approach that has been repeatedly examined and scrutinised through the RIIO-GD1 price control process and now RIIO-ED1. Ofgem's approach uses ONS ASHE wage data which was last published in December 2013. We are not aware of any updates to this data that would change the outcomes of Ofgem's draft determinations. Ofgem should have confidence in the process they have established and have due regard to the principles of good regulation of consistency and transparency.

In making its judgments on appropriate costs allowances, Ofgem have already fully scrutinised the additional costs we have justified in our specific annex to our business plan through questions and the detailed bilateral meetings with Ofgem and their consultant DNV Kema. Following the bilateral we provided supplementary information in responses to over 20 questions from your team justifying the key additional costs we face delivering the services our customers expect. We have received no further questions since these questions in May 2014.

Ofgem's regional cost adjustments recognise labour, pensions and contractors costs in our operating areas. We expect Ofgem to maintain the differentials based on their process. We are aware that other DNOs operating in areas where wage costs are below the national average have criticised the results of Ofgem's analysis, however we are unable to provide a

detailed critique of their position because they have not shared their assessment to allow wider scrutiny.

We have also provided further evidence as part of our submissions on real price effects that contractor costs are increasing faster in the areas we serve than across the UK as a whole which reinforces the need for both robust regional cost allowances and appropriate real price effect allowances.

We strongly believe that we have justified the additional company specific costs that Ofgem has included beyond the regional wage adjustments. We are confident in Ofgem's scrutiny of these costs and strongly refute any assertion from other DNOs such as Northern Powergrid that these represent a double count with labour costs. Companies have all had the opportunity to make their case for specific network costs and these should be a matter for the particular DNOs and Ofgem. We make note of the fact that Northern Powergrid itself benefits from having higher unit costs for its 20kV assets, which impacts Ofgem's disaggregated and totex benchmarking models. Our understanding is that 20kV assets are separately identified because Northern Powergrid uses them extensively in one of its networks, which equates to a company specific adjustment in all but name.

Northern Powergrid have also stated that the wage differential should be only 4% of totex in their response to the draft determination but have provided no supporting information. This view does not reconcile with either our or Ofgem's assessment based on the ONS data and we are unable to ascertain why from the extremely limited assertions published in their consultation response. DNOs that operate in cheaper areas should not expect the same allowances as other DNOs and we see no evidence that Ofgem has applied a different approach to Northern Powergrid, which disadvantages them as they assert.

We have asked that Ofgem make any additional DNO submissions made since the fast-track decision available to the other DNOs for comment before the final determination is made. It is not acceptable or appropriate from a process perspective for Ofgem to adjust company specific allowances for UK Power Networks based on private submissions by another DNO that we have not been able to review or had sufficient time to respond to.

To conclude, we have seen no further detailed evidence that the adjustments Ofgem have made are not robust or founded on sound independent data and we would not expect any change from the well-established regional adjustments process Ofgem has used in RII0-GD1 and for the RII0-ED1 fast-track and draft determinations at this stage in the process. Ofgem must ensure they do not set insufficient allowances for the delivery and maintenance of essential infrastructure in the UK's key economic region served by UK Power Networks.

Yours sincerely

A handwritten signature in black ink that reads "Ben Wilson". The signature is written in a cursive, flowing style.

Ben Wilson
Director of Strategy & Regulation and Chief Financial Officer