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Our ref	*Your ref*	*Date*
-		September 4th 2017

Dear Jonathan,

Open letter on the RIIO-2 Framework

I am writing on behalf of Western Power Distribution (South Wales) plc, Western Power Distribution (South West) plc, Western Power Distribution (East Midlands) plc and Western Power Distribution (West Midlands) plc in relation to Ofgem's consultation on the RIIO-2 Framework. Our detailed response to the questions is in Appendix 1. In addition, we have the following points, aligned with the key themes in the letter.

Overarching objective: The approaches adopted under RIIO-1 have driven significant improvements for customers and provides a strong platform to evolve. RIIO was intended to drive improvements in network performance, foster innovation, encourage engagement with stakeholders and reduce customer bills. The latest evidence from the annual reports is that network companies are rising to the challenge and that the framework is enabling networks to deliver the intentions behind RIIO.

WPD supports the retention of an eight year price control, inclusion of fast-track and the incentive it provides for companies to deliver high quality business plans. Alignment of the transmission and distribution electricity price controls is also a necessity. This will help to ensure that the potential benefits for consumers of the smart gird are fully realised with future network planning and investment conducted in a co-ordinated way.

Simplification: The amount of information collected by Ofgem by way of reporting requirements placed on network companies has grown considerably over the years. Ofgem should undertake a review of reporting requirements in terms of what aspects of the network's business is being reported and the level of detail required. Part of this assessment should be whether and how the reported information is being utilised and whether there is scope for simplification. In addition, moving into RIIO-2 there may be scope for simplifying some outputs and secondary deliverables.

Engaging the end-consumer: RIIO correctly places the responsibility to engage with stakeholders and deliver the outputs they require, with the network company. The stakeholder engagement incentive has supported this approach by ensuring customers are effectively engaged and that companies act on the feedback they receive. The feedback has been used to shape company business plans and ongoing actions. The stakeholder engagement process in RIIO-1 has worked well and this approach should be built on in RIIO-2.

Delivering innovation: The innovation stimulus is a success having had a significant impact on network companies both in bringing forward innovation projects and in ensuring a culture change within them. This has led to significant advances in the application of new technologies and techniques and the development of skills and capability within the organisations involved. The stimulus has already delivered substantial savings for consumers over the prices control period and so represents real value for money for consumers. This approach should be continued at RIIO-2.

Assessment of business plans: Although stakeholder feedback is important to shape company business plans, it is important that Ofgem retains overall responsibility for the assessment, comparison and benchmarking of the plans.

As highlighted at RIIO-1, the use of top-down regression is unreliable for cost benchmarking comparisons. (See the paper by Dr Richard Gibbens and Prof Stan Zachary attached to this response as Appendix 2). For this reason, only very limited weight can be placed on top-down benchmarking.

Should you wish to discuss any aspects of this response please contact me on the above direct dial number or via email asleightholm@westernpower.co.uk

Yours sincerely

Alison Sleightholm
Regulation & Government Affairs Manager

Appendix 1– Responses to specific questions in the consultation

1. Do you agree with our overarching objective for RIIO-2 and how we propose to achieve it?

WPD agrees with the overarching objective for RIIO-2 that it should ensure regulated network companies deliver the value for money services that consumers want and need. We support the approach outlined in the consultation.

The RIIO framework has worked well for electricity customers and is delivering a reliable, sustainable electricity network with lower distribution charges during a time of significant change. Additionally the RIIO framework is already demonstrating that it is adaptable to a wide range of potential future scenarios, such as the transition of Distribution Network Operator (DNO) to Distribution System Operator (DSO) enabling companies to innovate and respond proactively to consumer needs.

The second generation of RIIO controls should build on the learning from RIIO-1, keeping customers at the heart of the framework and retaining the emphasis on the core RIIO-1 principles of focusing on the outputs that customers want. Keeping it simple negates the need for costly micro-management of the inputs, as well as allowing regulated companies to earn fair returns whilst delivering value for money.

2. How can we strengthen the consumer voice (primarily end-consumers), in the development of business plans and price control decisions?

Our experience is that end customers are focused on the services received rather than the complex regulatory mechanisms involved. The challenge is on both Ofgem and the regulated companies to ensure that the engagement process is as simple and transparent as possible for stakeholders and allows them to contribute fully to shaping the services they require. The stakeholder engagement process in RIIO-1 has worked well and this approach should be built on in RIIO-2.

It is also important that engagement whether by Ofgem or by the companies is enduring and long-term rather than sporadic in nature, and only conducted for business planning or price control setting purposes. The Ofgem Customer Challenge Group fulfilled an important role during the first RIIO price controls, using an expert panel of stakeholders to represent customer views. This group should continue throughout the price control period so that expert stakeholders can build on their knowledge and ensure that Ofgem always have an independent group of experts available who represent customer views that they can call upon.

A further objective for RIIO-2 should be for customers to be provided with sufficient information in an accessible form so that they are able to form a sound view of companies’ performance. To this end the new RIIO accounts should include summary financial data that does not rely on an expert knowledge of accounting frameworks but which are broadly based on cash and show performance against the Price Control Financial Model (PCFM). This should be supported by published outputs information in a clear and simple format.

3. How should we support network companies in maintaining engagement with consumers throughout the price control period?

The RIIO process rightly places the requirement to engage with stakeholders and deliver the outputs they require with the companies themselves. The stakeholder engagement incentive has supported this approach by ensuring customers are effectively engaged and that companies act on the feedback they receive. This is different to other sectors such as water and airports where the engagement process is more formal and the regulator specifies both the engagement framework and scope of agreement that companies are expected to reach with stakeholders.

We support the continuation of a similar approach in RIIO-2, with companies building on the learning from RIIO-1 and extending the scope and depth of their engagement. It is correct that companies are responsible and held to account for engaging and satisfying stakeholders. The danger of an approach where the regulator is more prescriptive about the engagement is that it encourages a "box-ticking" approach with no driver for innovation and little real impact on the service to the end-user.

4. Does this structured approach to defining outputs provide the right level of clarity around delivery?

Yes, with some scope for simplification. The transition to outputs regulation has provided DNOs with greater flexibility in terms of how to operate their businesses most efficiently to serve their customers, whilst also ensuring that minimum standards of performance are achieved.

The use of the six categories allows clear categorisation of outputs and the analytical way in which Ofgem is defining outputs and assessing output delivery is both innovative and transparent. However, the use of both outputs and secondary deliverables is potentially confusing, e.g. does a secondary deliverable contribute to an output or is it a lower order of requirement? The picture is further complicated by having incentivised/non-incentivised outputs and the introduction of voluntary outputs or commitments into business plans.

In particular, Network Output Measures (NOMs) across the sectors should have a clearer link between activity and delivery of the output measure e.g. in ED there is a direct link between a risk delta and the asset replacement and refurbishment activities that will lead to the risk delta, but in transmission there is a target absolute level of risk that can be delivered through any activity (even good fortune).

The output categories and primary outputs will need to evolve to reflect the changing needs of the market and customers in RIIO-2, but the structured approach successfully used in RIIO-1 should be maintained with a focus on simplifying outputs to reflect customer requirements.

5. How can the outputs framework be improved, including the introduction of additional output categories for example around efficient system operation for distribution network companies?

It is important that outputs are focussed on the activities that customers value the most - providing a reliable network and good customer service.

The evolving role of DNOs and their transition to DSOs will give rise to new requirements. In turn, these new requirements should be linked to outputs and incentives where appropriate. For example, additional output categories and/or primary outputs could be developed for use of non-network solutions, facilitation of competition in flexibility services and other areas, and achievement of more efficient whole system outcomes.

Where new output measures are introduced, the rules and methodologies should be developed ahead of the price control so that there is a clear linkage between the metrics and the price control settlement. This will avoid the risk of mis-interpretation that could arise when mechanisms are developed some time later.

6. Did the outputs target the right behaviours?

Generally, yes. Network companies are becoming well-versed in and more focused on defining network solutions based on their outputs. This has enabled significant innovation in the types of network assets being deployed as well as the asset management and work practices employed.

An important principle is that outputs should be equally challenging for all licensees to ensure that there is no imbalance in the outperformance opportunity or penalty. It should not be possible for a licensee to easily gain from a mechanism just by catching up to the leading companies.

A rigorous consultation on outputs – particularly new outputs – should help to reduce or eliminate ambiguity and target the right behaviours by network companies.

7. How can we address areas of expenditure for which a clear output is difficult to define?

The delivery of outputs is the main measure that should be adopted, especially where there is scope for the work content to change and where innovation is being encouraged. The use of input measures should only be considered where there is a definitive programme that is to be delivered, where an output measure cannot be defined.

The detailed tracking of every aspect of delivery should be avoided as this potentially leads to Ofgem micro-managing the activities of licensees. The price control should be treated as a Totex price control giving licensees the freedom to apply different asset management strategies, rather than a collection of a series of volume drivers where every deviation leads to a micro adjustment of the settlement.

How companies achieve the outputs is up to them to propose in their business plans but the Totex each company proposes in their business plan needs to be assessed on an input cost basis – i.e. based on benchmarked units required and benchmarked unit cost because we know that totex regression is too unreliable to be useful.

8. Were the output targets and associated financial incentives set for RIIO-1 appropriate, reflecting what consumers value and are willing to pay for?

Yes. Customers value network reliability and affordability most highly. DNOs have managed to achieve significant improvements in reliability, as can be seen in IIS metrics. IIS targets are based on average performance over the last few years, therefore the improvement that DNOs have made will only make their future IIS targets more stringent as this performance is "locked in" and customers will benefit from this improved performance as BAU when the price control is reset. At the same time as network performance has improved, distribution network charges have reduced.

We also have the following comments on specific output targets:

Totex Incentive Mechanism (TIM)
There is a need for a mechanism that rewards companies for delivering works programmes efficiently. This leads companies to innovate and drive for efficiency improvements. However, TIM should only reward genuine efficiency improvements, not just provide a reward for under-delivery.

Connections
Time to Quote (TTQ) is a valid measure that gives customers a quick response to enquiries.
Time to Connect (TTC) is a flawed measure and does not represent what customers want. Customers want a timely connection (when they want it), not a quick connection having paid for it.

Network Reliability
The Interruptions Incentive Scheme (IIS) which has been in place since 2001 has been particularly effective in delivering improved reliability. The setting of IIS targets should be reviewed such that the weighting in favour of DNOs' own performance is removed.

Given experience in RIIO-1, Ofgem and the network companies are now in a much better position to 1) establish reasonable and meaningful output targets for RIIO-2 and 2) gauge customer willingness to pay any associated financial incentives through stakeholder consultation than they were prior to the RIIO-1 price control periods.

9. What changes in the RIIO framework would facilitate returns that are demonstrably good value for consumers?

The RIIO objective is to deliver long-term value for money network services for existing and future consumers.

Firstly, it is essential that consumers understand what it is that the network companies are delivering for them and at what cost. Only then can consumers consider whether this is good value and provide comment and input into the things they want their DNO to deliver.

At a high level consumers knowing they are paying approximately £86 per year through their electricity bill for WPD to operate, maintain, and replace where appropriate, all of the electricity distribution assets in their area to ensure consumers receive a safe and reliable supply 24 hours a day, 365 days of the year, enables consumers to compare the service they receive (but don't necessarily see) with other products and services they regularly use, such as telecoms, internet, travel, retail etc.

Consumers need regular, reliable, timely and accessible information in order to assess the value they receive from their network operator. Therefore the accessible RIIO accounts should be supplemented with a report on outputs in standard form within the same timeframe as the filing of the accounts. This will help ensure that demonstration of the costs and outputs and hence value of the price control is easily understood by consumers.

Going in to RIIO-2, the framework needs to further incentivise innovative and efficient expenditure and retain stable long term investment. It also needs to give flexibility to network companies to deliver new and existing services as required by consumers and hence should focus on outputs/outcomes not inputs.

Providing this flexibility will enable networks to continue to look at new ways of delivering the services that customers want and value in the most efficient way possible.

10. How can we minimise the scope for forecasting errors?

There are a range of issues around forecasting errors:

Ofgem should look to do all it can to provide clear guidance to network companies when forecasting to ensure there are no forecasting errors with regards to misunderstanding the question actually being asked. Given the extent of uncertainty in network demand forecasting due to the uptake of low carbon technologies, Ofgem should provide common macro assumptions as was the case with the DECC low carbon scenarios at ED1.

“Errors” can also materialise due to key assumptions that are made during the forecasting process. There will always be some form of “errors”, but adequate sensitivity analysis at the start of the process to understand the source and potential magnitude of any errors is the key consideration.

Where possible, forecasts should build on historical data and trends with a requirement for justification of significant variations from these trends.

Ofgem analysis during price controls should focus on areas where there appears to be a forecasting error (especially where deviation to business plan forecasts occurs early in the price control). This would seek to identify where an over-provision has been included in the Business Plan or where significant re-phasing of work has been carried out by the licensee.

11. What constitutes a fair return for a regulated monopoly network company, and how can we ensure that returns remain legitimate in the eyes of stakeholders?

Network companies need a return which will enable them to finance their activities and secure long term stable investment.

Timely and transparent reporting to stakeholders, for example through RIIO accounts, should provide a reliable comparative source of how and where companies are making their returns.

Returns that are made as a result of running an operation more efficiently should be clearly identified along with specific examples of how the efficiencies were achieved.

At the start of a price control the range of incentives included in the price control driving companies to operate more efficiently should be clearly set out, along with details of how benefits are shared with consumers/stakeholders in the current and future price controls.

12. What factors do you think are relevant for assessing and setting the cost of capital so it properly reflects the risks faced by companies?

This is a very technical area. The use of independent specialist consultants to produce an up to date review of the current financial environment is the right starting point.

Factors which need to be considered:
- Cost forecasting risk
- Embedded debt and future debt issuances
- Market volatility/historical performance

Striving to attain the optimal financing mix, considering the source of funds, interest and tax implications are key component parts of the process which Ofgem has undertaken historically as part of its price control setting process.

Setting costs of capital is a forward looking process. The RIIO framework uses indexing of the cost of debt to avoid the risk of relying on the point estimates used at the time the cost of capital are set.

There are no reliable indexes for the cost of equity and so the point-estimate risk for the cost of equity is inherent in the RIIO process.

The indexing of the cost of debt removes the point estimate risk once the whole cost of debt is set by the indexing process. (i.e. once the "trombone" is fully extended). However, in circumstances where a prolonged low interest rate environment continually reduces the allowed cost of debt there may be a mismatch between the RIIO indexing which is aimed at being neutral in the very long run and the credit requirements of the companies. Credit Rating Agencies do not typically rely on forecasts that are longer than 5 years. Therefore, in circumstances where a prolonged low indexed cost of debt reduces credit ratios over the short term the creditworthiness of companies may be adversely affected by a purely indexed cost of debt and the ability to raise new capital may need to be strengthened by other means.

13. Can we improve our methods for the indexation of the costs of debt and equity?

There are a wide range of options around indexing the costs of debt and equity. Selecting the right indices and time period are two of the key issues to ensure any indexation is robust and delivers the required outcome.

For example moving to shorter indexing periods may make the results more reflective of the immediate current environment, but can introduce significantly more volatility.

Careful consideration of both new and embedded debt needs to be factored in as part of any assessment.

Any change to the indexation of cost of debt and equity would need to be viewed "in the round" with other aspects of financeability to ensure long term stability for stakeholders.

14. Are there specific amendments to any core aspects of financeability that we should be considering in light of performance during RIIO-1 and the change in the financial environment?

A review of all the component parts of the financeability framework should be undertaken by Ofgem as part of the RIIO-2 price control. This process should consider all the price control factors in the round and include consultation with rating agencies to determine clear thresholds for maintaining investment grade ratings.

15. Should we consider moving to CPIH (or another inflation index) and how should we put into effect any change to ensure it is present value neutral for investors?

Price controls should be linked to the most relevant and robust inflation index available. Any changes to the index should be conditional upon there being a market in securities for the inflation index used and the effect of any change should be demonstrably neutral.

There are a number of statistical problems that have been highlighted with the RPI measure, which uses a discredited formula for calculating the rate of price rises. Therefore reverting to an approved index which is used elsewhere by Government makes sense.

All else being equal, changing the way revenues are indexed should have no impact on the Net Present Value of forecast revenues.

16. Do you think there are sufficient benefits in aligning the electricity price controls to off-set the disadvantages we have outlined?

Yes. Given the need for greater coordination between the National Grid and DSOs, aligning the price control period would help to ensure this coordination and the many benefits that this coordination would create for customers. One potential disadvantage is the significant coincident burden such alignment would have on the resources for all involved parties (network companies, Ofgem, stakeholders).

It is, however, important to recognise that the coordination between NGET and DSOs should not be limited to once every eight years, it should be embedded in work practices to become business-as-usual (BAU). The focus should perhaps be on establishing processes and mechanisms that would allow this, to augment what would be "one-off" alignment through coincident business plan submissions.

Alignment of many outputs and incentives is an important place to start where the NGET and DSOs are both to be involved in ultimate service provision. Ensuring all parties have the appropriate logic for working together for whole system benefit needs priority attention as part of the development of the RIIO-2 framework.

17. Are there any other realignment options we should consider?

We support aligning the Transmission and Distribution price control periods.

18. What amendments to the RIIO framework, if any, should we consider in supporting companies to make full use of smart alternatives to traditional network investment?

We believe that the current RIIO framework provides sufficient incentives that support the full use of smart alternatives to traditional reinforcement. The current uncertainties in the growth and pattern of output/usage in both generation and demand encourage the use of smart alternatives to defer decisions on traditional network investment. However, the relatively unknown long term effects of these solutions, and the increased operational costs involved in the creation, assessment and implementation of smart solutions can impede BAU usage. The RIIO framework should recognise that the overhead costs involved with undertaking advanced network options assessment will not reduce in line with the overall Totex savings compared to traditional reinforcement. It should also be recognised that DNOs further along the DSO transition who are actively assessing and offering alternative connections will have increased operational costs compared to traditional DNO investment processes.

The development of smart alternatives has been significantly helped by the access to innovation funding. The continuation of some form of innovation funding will allow more smart alternatives to be developed and deployed in a timely manner.

19. Given the uncertainty around demand for network services, how much of an issue might asset stranding be and how should this risk be dealt with?

The use of smart alternatives helps by allowing decisions on more costly investment to be deferred until there is more certainty associated with the changing usage patterns.

DNOs should be actively providing leading indicators on where capacity is restricted and where commercial mitigation actions may be required in order to stimulate missing markets and build capability for Distributed Energy Resource provided flexibility. This will help widen the options available to DNOs when using flexibility to mitigate uncertainty.

Whilst there is some risk of asset stranding, this is mainly associated with demand, as in general, generation contributes significantly to the reinforcement associated with its connection if the customer is unable to take advantage of the alternative smart connection arrangements available.

On the demand side, the risk tends to be more one of timing of the investment rather than whether it would be stranded for all time. The development of scenarios and Network Options Analysis type approaches on the distribution network would help to reduce the risk of inappropriate or wrongly timed investments.

Looking more widely, a whole system approach is important. For example the electrification of heat and transport may be at the risk of gas assets being stranded, with the flipside of that risk being the requirement for significant reinforcement of the electricity network. This will need uncertainty mechanisms such as a logging up mechanism for electric vehicles (EVs) and similar mechanisms for domestic heating for gas and electricity respectively across the RIIO controls.

20. How do we need to adapt the RIIO framework and the uncertainty mechanisms in particular, to deal with this uncertainty?

We believe that the uncertainty mechanisms currently within the RIIO framework will continue to be appropriate for RIIO-2.

In our view, allowing flexibility and improvement in the uncertainty mechanisms is a better option than shortening the price control period. A focus on Load Related Expenditure (LRE) with a link to Low Carbon Technology (LCT) uptake volume metrics, for example, a mechanism that adjusts allowances in response to market changes.

21. Is an eight-year price control period with built-in uncertainty mechanisms still appropriate given the greater range of plausible future scenarios?

Yes. We strongly believe that Ofgem should aim to maintain the eight year price control period and enhance the built-in uncertainty mechanisms. It is very difficult for network companies to innovate and see results in time periods shorter than eight years. It would be ideal if network companies are given targets that align to customer needs, and then left to deliver those targets in a way that it is economically favourable.

Shorter price control periods also have the drawback of imposing a resource burden on Ofgem and network companies more frequently. Preparing and submitting business plans is disrupting for network companies and is not necessarily a productive activity to benefit customers. Similarly, an intensive and frequent cycle of price control assessments for Ofgem does not allow time for observation of the effectiveness of price control settlements.

22. What improvements should be made to the assessment of business plans?

We have identified two key improvements:

1) The development of assessment approaches ahead of business plan submission, so that approaches are pre-defined enabling licensees to provide the appropriate explanations minimising the need for prolonged and extensive supplementary question processes.

2) The transparency of analysis and derivation of conclusions e.g. sharing benchmarking calculations with licensees to allow licensees to cross check that details have been transposed correctly and enables a peer review of Ofgem calculations, reducing errors.

Furthermore as discussed during the RIIO-ED1 process the use of top-down regression is unreliable for cost benchmarking comparisons. (See the paper by Dr Richard Gibbens and Prof Stan Zachary attached to this response as Appendix 2). For this reason, only very limited weight can be placed on top-down benchmarking.

Disaggregated benchmarking will produce variances depending on different business models adopted by companies. For example, if outsourcing construction contracts on a turnkey basis increases construction costs compared to an in-house approach to construction projects then that increase should be at least offset by a reduction in indirect costs compared to the in-house approach construction projects. If it is not, then outsourcing on a turnkey basis is costing consumers more for the same work.

23. Should we give further consideration to companies' historic performance against their business plans?

Historic performance should be used to inform both whether licensees have a consistent track record of delivering outputs and also whether their business plans have been sufficiently robust to anticipate actual activity levels. Historic activity may give an indication of future need if the reason for such continuation is sufficiently well explained and justified. Whether variances to historic trends are expected or not, licensees should explain and justify the activity levels in their plans. In circumstances where previous plans have proved materially inaccurate additional justification and explanation would obviously be required.

24. Should we determine the revenues an "efficient" network company requires before seeking information from the companies themselves?

Whilst it is perfectly valid for Ofgem to calculate a reference model, so that submissions can be compared to it as part of cost assessment, it should not be published as a reference for business plan pre-submission.

If the reference model is published there is a risk that licensees will tend towards the reference, rather than differentiating themselves, especially if the IQI process continues to provide rewards for licensees that submit business plan values in line with Ofgem's views. As a result, the process of price discovery of efficiencies will be obscured.
The reference model should not be viewed as the perfect answer because licensees will have more detailed knowledge of asset management requirements and therefore may provide and justify different work programmes and associated costs.

25. What has an eight-year price control period allowed network companies to accomplish or plan for that would not have occurred under a shorter price control period?

We strongly believe that Ofgem should aim to maintain the eight year price control period.

- It has provided licensees the time to apply leadership focus on how the work programmes are to be delivered; and
- It provides time to develop, test and implement innovative techniques and commercial arrangements, for example the transition to DSO; and
- A Totex approach provides flexibility for allowances to be redirected to changing business needs without the need for regulatory intervention. Five year price controls provide limited scope for this with business plans being submitted two years before the end, being prepared for at least a year before hand and previous price controls being closed out for the year(s) immediately after the start of the new price control.

26. How well has the IQI and efficiency incentive worked in revealing efficient costs through the business plan process and encouraging efficiency throughout the price control period?

The premise of incentivising efficiency through the IQI mechanism is a good one.

However, it is essential that any incentive mechanism focuses on output volumes as well as unit costs to ensure network companies are delivering what consumers require. This would indicate that any underspends are a result of real efficiencies.

To encourage network companies to respond to changing consumer needs, there could be a link between demand caused by macroeconomic factors not envisaged when business plans are submitted and potential flex in the IQI sharing factor.

27. What alternative approaches could we consider to encourage companies to give us high quality information that minimises the damage from their information advantage?

Licensees provide extensive data returns each year and greater opportunity should be taken by Ofgem to carry out analysis on the data provided as part of annual data returns. WPD provides high quality information in a timely manner to Ofgem, this is essential for price controls and is already a licence requirement. We operate in a transparent way and engage with Ofgem throughout the price review period.

Benchmarking models used at the time of assessing price controls can be applied to annual data/multi-year data ahead of price control analysis. This can provide the direction for further regulatory analysis and use of consultants to increase Ofgem knowledge to minimise any perceived information advantage.

28. What impact has the innovation stimulus had on driving innovation and changing the innovation culture?

The recent and historical innovation stimulus available to DNOs has enabled the UK to lead on innovation within the Electricity Industry worldwide. It has allowed a higher level of risk to be taken in trying new techniques and technology and allowed DNOs to simultaneously develop a broad pipeline of innovation projects. It has enabled earlier and faster development of new techniques and technology than would have been the case without the stimulus and given the platform to encourage deployment of these within companies. Without the stimulus, the level of risk taken in trying new technology and techniques would be lower.

The availability and continuation of innovation stimulus has allowed DNOs to develop internal capability for managing and delivering the innovation required in the future. The innovation culture fostered across all DNOs will also facilitate development at an Industry level.

29. Have the incentives inherent in the RIIO model encouraged network companies to be more innovative and what should we consider further?

We believe that companies have been encouraged to be more innovative from both the NIA/NIC process and the Totex approach allowing capex and opex solutions to be considered on an equal basis. WPD also believes that innovation should not be restricted to ideas from within our own organisation and our innovation projects demonstrate how we have developed ideas in conjunction with external stakeholders. We look forward to working in collaboration with Industry to fund and develop future NIA and NIC projects.

30. Do you agree that the scope of competition should be expanded in RIIO-2? What further role can competition play?

We support the approach set out in the consultation. Competition has been, and should continue to be used in the RIIO framework where it can drive better value for customers.

31. Which elements add the most complexity and how do you think that these and the broader RIIO framework could be simplified?

Stakeholders value the services that are provided and most are not interested in how they are achieved.

The main asset management areas that 'keep the lights on' are maintenance of equipment, repairs and asset replacement. Providing a simplified link between the expenditure on these direct asset management activities, the closely associated indirect activities that support the direct work and the necessary overheads of a business is difficult to achieve. Stakeholders may not be able to unpick the relationships between these activities and the need for the expenditure, making it difficult for them to specify a willingness to pay.

In many cases stakeholders are interested in small incremental areas of expenditure (e.g. undergrounding in areas of outstanding natural beauty) and therefore tend to provide a view on how these incremental areas should be addressed and funded rather than the larger expenditure on keeping the networks running.

Targeted engagement with stakeholders is key to understanding stakeholder requirements and how business plans should be shaped in response to their needs.

Complexity has been introduced into a number of output mechanisms. For example NOMs measures have led to a very data intensive and complex set of rules:

- Common methodologies for the collection of asset condition and criticality data with many data points required per asset;
- Health and Criticality calculation models that generate values for each individual asset;
- Assigning activities on each asset to an investment driver;
- Reporting the movements in extensive reporting templates;
- Collating all the individual contributions to the overall performance target.

The need for and benefit of such complexity should be reviewed in the working group developing a cross sector NOMs reward and penalty mechanism.

32. What improvements could be made to the format and presentation of the business plans?

Ofgem needs to be clear on the purpose of the Business Plan submission documentation, specifically are they brochures for stakeholders or documents that support a regulatory assessment? There is a balance to be struck between allowing licensees a free approach to presentation which makes it difficult for comparisons to be made versus the constraint of pre-defined requirements which limits the scope for differentiation.

To provide some structure, the content of business plan submissions should be specified for each investment driver. For example a core requirement could be;

- Prior price control performance (actual versus forecast)
- Delivery Track record
- Volumes forecast
- Cost forecast
- Drivers of cost levels
- Anticipated uncertainties / approach to management of uncertainties
- Contribution to measured incentives
- Relevant output measures (Ofgem specified versus voluntary)

The use of a template structure would allow greater comparison, but flexibility should be incorporated to allow the scope for licensees to add extra details to enrich the submissions.

Using specified scenarios in areas of uncertainty such as the use of the Department of Energy & Climate Change (DECC) low carbon scenarios also aids comparison.

33. Should the plans be revised at any stage during the price control, for example annually?

Price control business plans are aimed at the whole period; they are assessed across the whole prices control and they form the reference for assessment of price control delivery for the whole period. Making annual changes to the plans will create numerous reference points for stakeholders, which will lead to confusion. Mandating updates will also lead to additional regulatory burden.

The Business Plans should form a fixed reference against which changes and variances can be explained. Regulatory price control business plans should not be revised annually, but licensees should rightly be expected to revise activities in response to changing needs and not stick religiously to the agreed settlement.

34. Should we retain fast tracking and if so, for which sectors?

Fast tracking should be retained for all sectors. The potential to be fast tracked incentivises companies to submit a high quality business plan to Ofgem. It provides significant benefits to customers in that it encourages companies to reveal information earlier in the process and drives efficiencies and improves proposals for delivery from the companies remaining in the process. The fast tracked company has a reputational benefit and the early certainty of concluding its settlement one year earlier than the slow tracked companies.

35. Do we collect the right information in the right format and are there better ways to monitor the performance of companies?

As monopolies it is only right that the regulator monitors performance, delivery and value for money for customers.

Licensees have numerous reporting obligations and amount of data collected grows with each price control. Ofgem should therefore consider whether the data collected is being used or could be used. Any data being collected without a purpose should be reviewed and where appropriate removed from data collection obligations.

The development of ongoing benchmarking analysis should help to identify which items of data have a use for both Ofgem and stakeholders.

36. What are your views on how the changing role of the electricity SO should be factored into the RIIO framework, including whether or not the electricity SO should have a separate price control?

Given the split in Transmission System Operator (TSO) from Transmission Network Operator (TNO) currently being undertaken by National Grid, and the possibility of a further unbundling to an Independent System Operator (ISO) model, we believe that it will be appropriate for there to be a separate TSO price control.

The nature of the differences in recovery mechanisms available for the TSO would also reinforce the need to maintain the separation.

37. Do you agree with our broad stakeholder engagement approach set out above?

Yes.

It is particularly important that DNOs are involved in engagement on policy issues for RIIO-2 at an early stage as many of the key decisions that will need to be made for the gas and transmission RIIO-2 review will read across to the distribution review. In particular, DNOs or the Energy Networks Association will need to be fully represented on policy working groups.

The role of the Consumer Challenge group was particularly valuable during RIIO-1 and we would encourage Ofgem to re-establish this group as soon as possible.