

# **RIIO-ED1 Strategy Consultation**

## **UK Power Networks response to detailed questions**

### **Strategy consultation for the RIIO-ED1 electricity distribution price control**

#### **Overview**

#### **CHAPTER Three: Incorporating stakeholders' views**

**Question 1:** *Do you have any comments on our stakeholder engagement approach?*

**Question 2:** *Do you have any views on how our engagement process or that of the DNOs could be made more effective?*

Good stakeholder engagement is essential to running an efficient and customer-focused business and developing a well-justified business plan. The nature of a competitive market forces companies to listen to their customers and to react to their requirements. This bottom line implication for DNOs is weaker for most of their activities and it is important that they are incentivised to gather requirements and show that they have acted appropriately on stakeholder feedback. The RIIO-ED1 framework provides sufficient incentives to DNOs to do this effectively. The increase to up to 0.4 per cent of annual revenues as a reward under the Broad Measure of Customer Satisfaction (BMCS) will ensure that DNOs are appropriately incentivised. Companies that are able to demonstrate an effective engagement process will be able to realise funding whilst companies that run poor processes will be exposed to the financial risk of incurring additional expenditures with no associated revenues.

The additional inclusion by Ofgem of other external stakeholders in the development of the RIIO-ED1 framework has ensured that there has been appropriate focus on the key regulatory issues from an 'end user' perspective. The appointment of Ofgem's Consumer Challenge Group and the Price Control Forum are also welcome additions to the engagement framework, ensuring that the voice of the customer has been incorporated. We believe that this is something that Ofgem should consider as part of its ongoing RIIO framework.

Some stakeholder groups have requested that all DNOs coordinate their stakeholder engagement wherever possible. This has only happened to a limited extent, partly because there are some aspects of the process that need to be developed by individual companies with their relevant stakeholders. However, the amount of coordinated activities by DNOs to date has been limited. UK Power Networks believes that Ofgem should consider explicitly incentivising DNOs to all work collectively with certain stakeholder groups on issues (representative organisations of customers, vulnerable customers etc) to ensure that the administrative burden for external stakeholders is minimised.

#### **CHAPTER Four: Form and structure of the price control**

**Question 1:** *Do you have comments on the form or structure of the price control?*

**Question 2:** *Do you agree with our proposed changes to the RIIO-ED1 timetable?*

**Question 3:** *Do you have a view on the materiality of potential changes in allowed revenues/charges between price controls? Do you have proposals to address this?*

The form and structure of the RIIO-ED1 price control process is appropriate. We believe that Ofgem has appropriately balanced the time to allow DNOs to develop their business plans and the assessment of these plans. It is important that the assessment process remains proportional to the stage of the process. For the fast tracking process, we believe it is for DNOs to provide sufficient evidence in an appropriate format to enable Ofgem to take a decision on proportional treatment. If a company has not provided this

information, or if questions remain about a DNO's business plan, we would expect Ofgem to default companies into the full scrutiny or other proportionate treatment categories. The proposed changes to the timetable, particularly the use of a single stage fast tracking assessment process, are appropriate. We agree with Ofgem's proposal to implement the licence condition working group in March, after the publication of the strategy decision.

We believe that it is important that the RIIO-ED1 assessment process retains the ability for individual licensed networks (from a larger group) to be fast tracked. If a company has not provided this information, or questions remain about a DNO's business plan, we would expect Ofgem to default companies into the full scrutiny or other proportionate treatment categories. This should enable Ofgem, with minimal risk to consumers, to fast track individual companies who are part of a wider group.

Ofgem's decisions on the options to be implemented to address the concerns stakeholders have with regards to price volatility are proportional. We do not feel it would be in the interests of consumers to apply caps and collars around the changes in the allowed revenues. We also feel that in the development of a DNO's well-justified business plan, suppliers should have significantly increased visibility of proposed revenue changes and an opportunity to comment on them.

UK Power Networks has been discussing its draft RIIO-ED1 business plan with suppliers and these discussions have revealed that it is the visibility of individual DUoS price changes that they are also interested in. We note that Ofgem's volatility consultation does not address this.

#### **CHAPTER Five: Ensuring output delivery**

**Question 1:** *Do you consider that the proposed outputs and associated incentive mechanisms, taken together with other elements of the price control, will ensure that companies deliver value for money for consumers, and play their role in delivering a sustainable energy sector?*

**Question 2:** *Do you consider that the proposed outputs and incentive arrangements are proportionate (eg do we have too many or too few)?*

**Question 3:** *Do you have any views on the proposed outputs and incentives?*

UK Power Networks is supportive of the overall output and incentive mechanisms and the focus these will bring on DNOs to deliver value for money for consumers. We welcome the inclusion of the explicit obligations on DNOs to include the facilitation of the low carbon economy in the environmental output, and the widening of the social obligations output to focus on active engagement with other network operators, suppliers, and representatives of vulnerable and fuel poor customers. Both UK Power Networks' stakeholder engagement process in 2011 and our willingness to pay studies in early 2012 confirmed the suitability of the six output categories.

We believe that safety is such a fundamental indicator of a well run DNO that there is no need to further incentivise DNOs, through financial rewards, to improve their safety performance.

UK Power Networks is supportive of the continuation of the BMCS as the primary way to incentivise a DNO to improve its customer service. However, we believe that Ofgem should set absolute improvement targets for all DNOs in RIIO-ED1. We believe that the DNOs will be able to propose target levels of service as part of their business plan and Ofgem will have sufficient data to benchmark this proposed level of performance. Under the current methodology, the use of relative targets makes it difficult for DNOs to develop an investment case for service and system improvements, as DNOs have no ability to forecast accurately the incentive income from a customer service improvement, since the direction and magnitude of the incentive depends on the performance of other

companies. Absolute targets will also enable companies to reflect the expectations of their stakeholders in their targets – something that is not included in the current incentive. It will also be important to future proof this incentive for use up to 2023. There has already been significant growth in DPCR5 of contact from customers through other communication channels (social media). The satisfaction of these customers should also be included within the BMCS, and UK Power Networks has jointly been working with Northern Power Grid and the Institute of Customer Service to develop appropriate measurement and recording tools. This will be presented in time for the final strategy decision document.

UK Power Networks agrees that the losses incentive should be closed down in RIIO-ED1 due to the uncertainty in settlements data during the roll-out of smart metering. We also agree that it is not appropriate to continue with the DG incentive and that DG investment should be included as part of the IQI framework.

UK Power Networks is supportive of the concept to introduce an incentive to improve the average time to connect. We do not believe that it is in consumers' interests that an incentive rewards DNOs for just providing their existing time to connect. It is important that the incentive is simple to operate and reflective of the characteristics of a DNO's network. We would therefore propose that the incentive uses actual individual DNO performance data from 2012–13 and/or 2013–14. RIIO-ED1 targets for minor connections are based on an annual agreed percentage improvement. RIIO-ED1 targets for major consumers use a percentage achievement of agreed time to connect with the customer.

It is noticeable that the social obligation output does not have a specific incentive. UK Power Networks believes that Ofgem should implement a specific incentive to encourage DNOs to look at the issues of fuel poverty, consumer vulnerability and safety in a wider context than the specific obligations on a DNO would imply. The current BMCS stakeholder engagement incentive will not achieve the incorporation of this wider perspective. The social obligation incentive could take the form of a discretionary reward that specifically excludes any initiatives that are as a result of the service or function that a DNO currently fulfils.

UK Power Networks supports the proposed changes to the incentive framework for network reliability. The introduction of criticality into the Health Index and the reduction to 12 hours for the guaranteed standard payment for fault restoration are both important improvements for the RIIO-ED1 framework.

## **CHAPTER Six: Assessing efficient costs**

**Question 1:** *Is our proposed approach to cost assessment appropriate?*

**Question 2:** *Do you have views on our proposed use of proportionate treatment?*

**Question 3:** *Do you have any views on the criteria for assessing business plans?*

Ofgem's overriding philosophy that a toolkit of methodologies is required to assess the RIIO-ED1 business plans is the right one. The range of tools presented is comprehensive and should ensure that Ofgem is much better placed to deploy an appropriate mechanism for each cost category, rather than the more broad-brush assessments that have been witnessed in the past.

UK Power Networks is very supportive of virtually all of the proposals described, although we are a little concerned by the use of the upper quartile as the benchmark in all cost assessments. We would suggest that there will be cost categories where it is simply not appropriate to set a benchmark on this basis, and hence Ofgem should be prepared to vary it accordingly.

We note the fact that Ofgem intends to base its benchmarking on three periods of data (2010–2013, 2013–2015 and 2015–2023). This is the right approach as it is generally acknowledged that mixing historical and forecast data is often problematic. However, what is not clear yet is how these three views will be brought together. UK Power Networks believes that a greater weight should be put on forecast data and the justification that DNOs are able to provide on these costs.

Ofgem's criteria for the assessment of business plans are reflective of the learning from the RIIO-GD1 and RIIO-T1 assessment processes. The additional guidance on the business plan format and the supplementary annexes strikes an appropriate balance between accessibility for stakeholders and flexibility for DNOs in how the information is presented.

UK Power Networks recognises the need to provide appropriate rewards to companies for fast tracking, and the use of a fast tracking IQI matrix is the most appropriate incentive mechanism. For those companies which are not fast tracked but in respect of which Ofgem only has concerns with limited specific elements of their business plans, it would appear appropriate to allow DNOs to benefit from the fast tracking IQI matrix where their plans are approved. However, we recognise that this may introduce additional complexity and therefore, it may be appropriate to introduce a third IQI matrix for companies which are subject to 'other proportionate treatment'.

#### **CHAPTER Seven: Innovation**

**Question 1:** *Do you have any views on the role of innovation in RIIO-EDI?*

**Question 2:** *What should the funding threshold for the NIC be? Do you agree with our proposal to review it after two years to reflect learning from the LCN Fund?*

It is appropriate that the innovation framework that Ofgem has developed for RIIO-T1 and GD1 is also implemented in RIIO-ED1. The inclusion of an innovation roll-out mechanism (IRM) is an important addition to the framework. UK Power Networks believes that the allowance of a single window of application appears to be overly restrictive, as do the proposed trigger thresholds of the IRM.

We agree with Ofgem that a review of the effectiveness of the LCNF mechanism and the delivered benefits to customers is needed and it is an appropriate time to do this during late spring 2016.

#### **CHAPTER Eight: Managing uncertainty**

**Question 1:** *Do you have any views on the uncertainty mechanisms identified?*

**Question 2:** *Are there any additional uncertainty mechanisms required?*

**Question 3:** *Are there any mechanisms that we have included that are not necessary and why?*

The inclusion of a 'mid-period' review during the RIIO-ED1 period is important given the level of uncertainty on some output measures, particularly environmental. We agree that this review should be constrained to areas where there have been changes in governmental policy and the introduction of new outputs needed to meet the needs of consumers and other network users. We also believe that it should be extended to allow for the inclusion of learning, particularly implications for the regulatory framework from the DPCR5 Low Carbon Networks Fund review that is to be undertaken in 2016.

#### **CHAPTER Nine: Financing efficient delivery**

**Question 1:** *Do you consider that our proposed package of financial measures will enable required network expenditure to be effectively financed?*

**Question 2:** *Do you have any views on our proposed approach to assessing the cost of equity and the associated range of 6.0-7.2 per cent (real post-tax)?*

**Question 3:** *Do you have any views on the other elements of our financeability proposals?*

We agree with Ofgem that the majority of the financing principles have already been set out in the initial RIIO framework and have been further clarified for GD1 and T1. We would, however, draw out three further distinctions and enhancements that are needed to the framework:

- The level of uncertainty and ex-ante risk in the regulatory framework in RIIO-ED1 is higher than in DPCR5 due to the level and impact of the low carbon technology penetration. This should be reflected in the allowed cost of equity.
- In order to achieve an actual cost of debt in line with the index it is necessary to issue debt with a maturity of not much more than 10 years. This is much shorter than the lifetimes of our assets and introduces significantly more refinancing risk into the networks, making them more susceptible to capital market dislocations. UK Power Networks is therefore proposing to modify the cost of debt index to a 'trombone' index where the trailing average increases to 20 years over the next 10 years and then stays at 20 years. A 20 year trailing average would be consistent with companies issuing debt of up to 20 year maturity.
- UK Power Networks supports Ofgem's use of transitional arrangements in RIIO-ED1 for the movement to the new finance framework. UK Power Networks has proposed a single period straight line transition to the new regulated depreciation.

## **Appendix 1 - Strategy consultation for the RIIO-ED1 electricity distribution price control**

### **Outputs, incentives and innovation**

#### **CHAPTER 2: Overview of outputs and incentives**

**Question 1:** *We welcome respondents' views on the approach we have taken to develop the outputs framework.*

**Question 2:** *Do any of our proposed output measures present potential difficulties in ensuring the submission of accurate and comparable data?*

**Question 3:** *Should we use a percentage of allowed revenue or £m set using basis points of return on regulatory equity (RORE) to set caps and collars?*

**Question 4:** *Are there any aspects of our proposed outputs framework where the reporting requirements are likely to lead to disproportionate regulatory costs?*

UK Power Networks recognises the improved process that Ofgem has run to develop the outputs framework. The inclusion of external stakeholders has worked well in providing a 'challenge' to assumed standards and practices. We agree with the further clarity provided to DNOs with regards to the environmental and social obligation outputs. Further active participation from non-industry stakeholders should be encouraged for the remainder of the working groups. We agree that DNOs should be measured and challenged to facilitate the move towards a decarbonised economy. It is appropriate that companies should be asked to look wider than the social obligations within their direct control and look to work with other related industry parties. However, DNOs within vertically integrated groups (including generation/transmission/retailers) should not be rewarded for working with internal partners.

The DPCR5 framework has made a significant improvement in ensuring that DNOs provide information on a comparable basis, particularly costs. We believe that it is appropriate for this to continue into RIIO-ED1. However, the consequences of harmonisation should not be to stifle innovation within the ways that companies run themselves or to encourage movement to an average performance. The only area within the existing Outputs framework that requires further proposal is environment (transition to the low carbon economy facilitation). Although this is a challenge for DNOs, further explicit objectives and incentives within the NIC and NIA incentives should be set to encourage the appropriate behaviour and ensure the best returns for customers.

UK Power Networks believes that DNOs should be incentivised to improve the running of their networks and the level of risks. Therefore, rewards and penalties should be set relative to the size of the network, and it is appropriate for Ofgem to continue to set caps and collars based on a percentage of return on regulatory equity.

#### **CHAPTER 3: Driving sustainable networks**

**Question 1:** *Do you agree that a specific output or incentive focussed solely on the connection of low carbon technologies is not necessary?*

**Question 2:** *Do you agree with our proposals on the level of detail DNOs will be required to submit on the different scenarios in their business plans?*

**Question 3:** *Do you agree that an uncertainty mechanism is required to manage the uncertainty around the penetration of low carbon technologies?*

**Question 4:** *Do you agree with the three tier approach we propose to introduce for the recovery of the DNOs' costs during the smart metering roll-out?*

**Question 5:** *Should costs of load and generation growth for existing customers in profile classes 1-4 be socialised, until smart metering data is available?*

**Question 6:** *Should DNOs retain the ability to charge existing customers in profile classes 1-4 who install equipment which poses significant power quality issues for the network?*

**Question 7:** *If we socialise costs of existing profile classes 1-4 customers, will the use of system charging methodology need to be changed in order to protect IDNO margins?*

It is unfortunate that the proposed regulatory framework does not specify a specific incentive or output target on DNOs to connect low carbon technologies. We agree that the existing connections framework will provide sufficient protection against poor service for customers who wish to connect low carbon technologies, but this may not be sufficient to ensure that DNOs are incentivised to look for innovative solutions. However, given that under the most likely scenarios the connection of low carbon technologies onto networks is likely to be modest during RIIO-ED1, it is appropriate for the industry to gain experience to ensure the correct outputs are identified in time for RIIO-ED2.

It is a fundamental part of the development of a well-justified business plan to allow companies to have the freedom to develop a scenario which is specific to their network and the region they operate in, and which meets the requirements of their stakeholders. UK Power Networks believes that the imposition of any top-down scenario for the core business scenario is inappropriate and runs counter to the RIIO-ED1 framework. It is important that the requirements for business scenarios are clarified as soon as possible to enable companies to build a well-justified business plan; this decision cannot wait until February next year.

UK Power Networks recognises that for comparative purposes, it is appropriate for stakeholders to require DNOs to provide a detailed business plan against a common reference scenario. We welcome Ofgem's proposal that this should be against a single scenario, but question whether this should be the "DECC low scenario". Given that this scenario is no more than business as usual, we would propose to use one of the two "DECC mid scenarios". We do not believe that it would be appropriate for DNOs to provide a detailed business plan against all of the DECC scenarios as this would require a disproportionate amount of resources which would present significant challenges to be used appropriately in the business plan assessment process.

Given that there are four main drivers to uncertainty with regards to the future connection of low carbon technologies, UK Power Networks supports the need for a specific uncertainty mechanism. As well as the normal uncertainty of the volume of load growth, the future growth of low carbon technologies is uncertain due to the unknown level of their take-up, the level of electrical demand that this will require, and the additional distortion that clustering will cause to a network operator. Any uncertainty mechanism should incentivise DNOs to enable the connection of low carbon technologies with the lowest level of network investment. Therefore, it is inappropriate to pay DNOs using a simple volume driver based on the number of low carbon technologies to connect to a network multiplied by an average unit cost. This is not in the long-term interests of consumers as it will reward DNOs for doing nothing in certain network circumstances (i.e. when there is already sufficient capacity headroom in the network).

Given the continued level of uncertainty, and the lack of direct DNO control, it is appropriate for the costs incurred during the smart metering roll-out to be treated differently during the RIIO-ED1 period. The three tiered approach suggested by Ofgem is appropriate as it will allow for the efficient recovery of costs incurred. UK Power Networks is supportive of the development of a bilateral SLA framework that is used to manage the roll-out of smart metering. This framework should focus on ensuring that customers get the best possible service and should not be used to fund inefficient behaviour by either suppliers or distributors. The appropriate application of tier 2 and tier 3 costs will encourage this.

UK Power Networks recognises that the forecast increase in the connection of specific low carbon technologies will increase the overall level of electrical demand. Under the existing connection agreement framework, where a customer exceeds their agreed



connection capacity, DNOs have the ability to charge for additional costs incurred in distributing the increased load. However, it is not practical and/or possible at the moment for the increased load to be identified at source in the majority of cases. It is, therefore, appropriate that the costs incurred should be treated as background growth (both generation and demand) and socialised through DUoS charges. UK Power Networks does not agree that the point of demarcation should be based on settlements profiled classes 1–4 as it would appear more pragmatic and simple to use either the demarcation of half metering or voltage (i.e. HV and above).

The case as to whether this should be changed once smart metering has been introduced also remains to be proven, as it is unclear whether the improved ability to charge customers specifically for increased demand data will justify the increased costs of capturing and processing all smart metering data and the increased complexity of billing systems. UK Power Networks believes that further research is required before a final decision can be taken. Where DNOs do identify that customers are causing a disproportionate impact on required network reinforcement through inappropriate actions (e.g. through the use of non-approved equipment with poor power factor), then DNOs should continue to be allowed to pass these costs on to their customers.

#### **CHAPTER 4: Reliability and safety**

**Question 1:** *What are your views on the primary outputs and secondary deliverables for reliability and safety? In particular:*

- (a) Do you agree that these are appropriate areas to focus on?*
- (b) Are there any other areas that should be included?*

UK Power Networks is supportive of Ofgem’s proposed primary and secondary outputs with regards to reliability and safety as they are a logical improvement on the measures used in DPCR5.

With regards to **health indices**, we believe it is appropriate and proportionate to include criticality of assets as part of the new secondary output measure for RIIO-ED1. An additional focus on the importance of assets (customers, safety, network resilience etc) is no more than our stakeholders would expect of a well run DNO during RIIO-ED1.

With regards to **load indices**, UK Power Networks believes that a measure of priority/criticality should be included that recognises the short- and long-term drivers to asset maintenance and replacement. However, we recognise that it is unlikely that this will be introduced across all DNOs in time for the start of RIIO-ED1.

We are very supportive of Ofgem’s desire to harmonise the LI band grades that DNOs use to assess their assets. However, we would question why companies should be allowed to justify increased network reinforcement by assuming low upper boundary tolerances of when assets should be reinforced. We do not believe that this is in the long-term interests of customers (due to the increased and unnecessary capex programmes) and Ofgem should challenge DNOs to maximise the utilisation of their assets before reinforcement is triggered. Due to the unique constraints on our network (particularly in London), we have developed a number of innovative network operating procedures and techniques that appear to allow us to utilise our assets more than other DNOs and enable us to have higher trigger points for reinforcement. We are proposing to work with Ofgem and other DNOs (through the Reliability and Safety Working Group (RSWG)) to use this upper boundary as the trigger point for network reinforcement for other DNOs, rather than assume an average standard.

We agree with Ofgem that DNOs should not be paid for improvements in their **safety performance** during RIIO-ED1. Despite having one of the best safety records in the industry since our change in ownership, UK Power Networks has set a target of zero harm for all direct and contracted employees as well as for public safety. This is an



extremely ambitious target that few organisations are able to achieve; however, we believe the setting of such an ambitious target will drive real improvements in our safety performance much faster than any potential incentive payment. We do not believe that DNOs should be rewarded for such a fundamental requirement for an excellent company.

For guaranteed standards, UK Power Networks is supportive of Ofgem's proposals, particularly the reduction to 12 hours for fault restoration when penalty payments on DNOs are triggered. Most companies are already using this standard to improve their fault restoration and it is not unreasonable for customers to benefit from this improvement during RIIO-ED1.

UK Power Networks recognises that the current incentive on 'worst served customers' is only marginally effective and therefore agrees that there should be a review of the incentive to encourage DNOs to manage multiple interruptions to individual customers better. We would suggest that further work is needed before finalising the position for the final RIIO-ED1 regulatory framework.

## **CHAPTER 5: Environmental impacts**

**Question 1:** *Will our proposed approach ensure effective losses reduction actions?*

**Question 2:** *Will our proposed losses discretionary reward provide the required incentive on DNOs to reduce losses? Should this be awarded twice during ED1 or more frequently?*

**Question 3:** *Should DNO actions to identify and address electricity theft be encouraged through an approach outside of any losses reduction mechanism? Do you have any views on the proposed approach, or any alternate proposals, that we should consider?*

Ensuring that DNOs minimise losses through improved data quality management and the use of the most cost-efficient technological solutions is an important requirement for the regulatory framework in RIIO-ED1. With the roll-out of smart metering during RIIO-ED1 there is likely to be significant disturbance to billing and settlement data that will make monitoring losses effectively very difficult. Given that many of these potential drivers to reduced data quality are outside of the control of DNOs we believe it is appropriate that the existing losses incentive is not used during RIIO-ED1. UK Power Networks agrees with the primary thrust and structure of Ofgem's proposed losses reduction mechanism – in particular, the move away from a settlement measurement approach after the issues of recent years.

We consider that the proposal will have the effect of re-focusing DNOs' losses reduction efforts into technical rather than non-technical losses, and of integrating a losses management strategy into the core business plan (rather than it being an incentive 'add on'). This incorporation into wider business plans has the advantage of better opening up the nature, priorities and costs of losses management to stakeholder engagement, influence and prioritisation. We would expect this to add to the overall robustness and justification of a fully funded ED1 business plan. We also agree that it is appropriate to incentivise technical loss reduction through a licence obligation on data quality and a discretionary reward during RIIO-ED1. We would suggest that £4 million per annum across the industry will not provide sufficient incentive to DNOs to invest in the programme; however, will it discourage DNOs from bringing forward their most innovative and efficient actions until just before either of the two award years? Perhaps a better approach would be a £5 million discretionary reward to be awarded during each of years four to seven, with a final £12 million in year eight which includes a 'best in period' element which may reinforce a previous award.

Further clarity is also required to be developed before February on how such a scheme may work and how DNOs would be rewarded under it.

Once the smart metering roll-out has been completed, we would agree with Ofgem that it is appropriate to develop a revised loss reduction incentive – although we would question whether this should use settlement data as the means of measurement. Given that the smart metering roll-out and subsequent data quality implications are unlikely to be fully resolved until 2020 or 2021, it is appropriate that this revised incentive should be introduced for the beginning of RIIO-ED2.

At present, DNOs have a licence obligation under SLC 27 to report interference with and damage to metering equipment to suppliers and equipment owners. Under DCUSA, the responsibility for theft is explicitly laid out, placing responsibility for “Theft in Conveyance” (abstraction of electricity for use otherwise than at a premises for which there is a metering point registered by a supplier) with the DNO and all other theft with the supplier. Ofgem’s approach is not, therefore, proposing to change this principle.

UK Power Networks agrees with Ofgem that there are commercial disincentives for suppliers to tackle theft and concurs with Ofgem’s proposals to amend the Supply Licence and to put in place mechanisms similar to those proposed for the gas market.

We agree that existing industry code governance arrangements are the best mechanism for implementing such arrangements, although we are concerned that this process is not always quick and can be obstructed by parties that do not want to see the changes made. A DCUSA proposal by a DNO to require suppliers to enter into settlement ‘stolen’ energy identified by revenue protection services (DCP 054) has been running since October 2009, and having spawned a BSC Issue and a further DCP to clarify the definitions of theft, it is still in the ‘working group’ stage.

In the short term, UK Power Networks provides a revenue protection service (through an external service provider) to suppliers (although not all suppliers choose to take up our service in full) and expects to be able to continue to do so until the end of the DPCR5 period.

We also agree with Ofgem’s proposition that DNOs should be able to recover their reasonably incurred costs for tackling theft. However, the framework does not elaborate on how those costs would be recovered – if they were to be solely from the illegal connectee then DNOs would face exactly the same disincentives as suppliers face at present, where the costs of investigation and repair of damage to the network are not always recoverable. Our solution to this is for the industry-wide measures for tackling theft to encompass DNOs as well as suppliers, and to be on an equal footing. The DNO’s base costs for investigating and resolving unregistered premises and supporting an industry-wide “Electricity TRAS” should be allowed within the base ED1 allowances.

**Question 4:** *Do you think that further guidance should be provided with regard to the use of the 10% allowance for undergrounding? If so, what form should this guidance take?*

**Question 5:** *Are National Scenic Areas (NSAs) sufficient to allow for effective use of the scheme in Scotland in the protection of visual amenity?*

**Question 6:** *Do you agree with our proposals with regard to DNO assessment and stakeholder engagement within the undergrounding scheme?*

**Question 7:** *Do you agree with our proposed approach for BCF? Do you consider there are any additional elements that should be included within the BCF reporting scope?*

**Question 8:** *Do you agree with our proposed approach to SF6 monitoring, reporting and management?*

**Question 9:** *Do you agree with our approach for fluid filled cables?*

**Question 10:** *Do you agree with our approach to noise reduction?*

**Question 11:** *Do you agree with our assessment of the need for an additional environmental discretionary reward?*

The current Areas of Outstanding Natural Beauty (AONB) undergrounding incentive provides sufficient clarity to DNOs on how it should be used. Our stakeholder engagement for DPCR5 showed that stakeholders value this scheme and that it should be widened to allow for the undergrounding of cables when they can be seen from an AONB. Although this will increase slightly the administration of the scheme, it would enable some significant outstanding issues to be resolved, as it makes little sense to only allow undergrounding where a scheme directly crosses an AONB.

UK Power Networks incorporates the undergrounding of overhead lines as part of its business-as-usual investment assessment criteria, particularly as an option to improve quality of supply. In many cases the cost benefit analysis does not provide a robust business case. We believe that it is appropriate that the requirement for justification for undergrounding remains with the DNO except in the case of AONB.

The proposed approaches for incentivising DNOs in RIIO-ED1 for Business Carbon Footprint and for DNOs to monitor, report and manage SF<sub>6</sub>, fluid filled cables and noise reduction are appropriate in RIIO-ED1.

UK Power Networks can see merit in allowing DNOs to compete for an environmental discretionary reward during RIIO-ED1; although, to avoid duplication and unnecessary administrative overheads, it would appear sensible to widen the scope of the losses reduction discretionary reward to encompass all environmental objectives, while at the same time increasing the amount of money available to companies.

## **CHAPTER 6: Customer satisfaction**

**Question 1:** *Do you agree with our proposal to retain the Broad Measure of Customer Satisfaction (BMCS) and increase the maximum revenue exposure?*

We support the proposal to retain the BMCS and increase the maximum revenue exposure with a proposed movement to the use of absolute targets. There are, however, a number of amendments that we believe should be made to improve the current BMCS and future proof it as much as possible for the RIIO-ED1 period.

**Question 2:** *We seek views on the approach to setting targets for the RIIO-ED1 period, including whether these targets should be fixed for the price control period or should be responsive to changes in industry performance.*

We support the need for setting targets as years pass rather than for the whole RIIO-ED1 period upfront. To set them upfront risks a DNO achieving the target early on and then having no incentive to further improve its customer service. However, this proposal is not without its problems, including developing a method that does not set a target that increases (or decreases) by too large a level, therefore meaning a DNO is unable to achieve the new target.

**Question 3:** *We seek wider stakeholder views on whether interruption customers that have been proactively contacted by the DNO via new methods of communication (eg social media) should be included in the customer satisfaction survey.*

We fully support the expansion of the measure to include both inbound and outbound methods of communication (i.e. channels), and these must include new technologies, such as social media, in line with customer expectations of having channel choice. This was further emphasised by the positive comments to this proposal made by Age UK at the Ofgem Customer and Social Issues Working Group (CSIWG) meeting on 23 October 2012. With the above in mind please find set out in the table below a list of potential channels and a short description of how these could be incorporated into the incentive.

<b>Channel</b>	<b>Inbound</b>	<b>Outbound</b>
Phone	Current scheme – no changes	This would include ALL customers DNOs have proactively contacted via this process (non-deselected – see notes)
Social Media (including Twitter, Facebook, Online Community etc)	Only includes customers that have had a direct message (DM) conversation and provided full address details. From the DM they can be invited to follow a link to a website hosted by the independent survey company to take part in the survey.	Broadcast messages stating areas are experiencing a power cut are excluded as no direct interaction. Where a customer requires more information that can be guided to a direct message (DM) and from there invited to take part in the survey. Barclays and HSBC currently include Twitter as part of their customer service measure.
Text	Scheme could operate by the customer texting in their postcode and the DNO then responding in one of two ways. 1) DNO rings customer and updates them on fault situation or rings them to ascertain fault details as no fault known at that postcode, in which case these could be included in the outbound phone category and the independent survey company would include them in their sample. 2) DNO responds by text giving details of fault/restoration. Independent survey company would include them in their sample.	This could be based on a scheme whereby the customer registers their mobile and postcode with the DNO and the DNO then proactively texts out when there is a fault affecting that postcode. Submitted data would need to include ALL customers that DNO has proactively contacted via this process (non-deselected – see notes). The independent survey company would then include an opening question to the survey to check if the customer had received the message before proceeding with the survey.
Phone message	Current scheme – no changes	Broadcast outbound recorded message to all numbers affected by a fault. Submitted data would need to include ALL customers that DNO has proactively contacted via this process (non-deselected – see notes). The independent survey company would then include an opening question to the survey to check if the customer received the message before proceeding with the survey.
Email	Includes all customers who have contacted the DNO via a specified power cut email address with specific address details of the power cut. If response is by email (it could be a call back to a customer so would therefore be in outbound phone), the final close-out message from the DNO should include a link to an online survey.	Would not be the chosen method to proactively contact customers as not real-time enough.

<b>Channel</b>	<b>Inbound</b>	<b>Outbound</b>
Website	DNO publishes live (or near to live) details of faults on its website. Customers are then invited to complete short form with the relevant details (their address/contact details/time power went off) which is sent to the DNO to process dynamically as if it were a call to its power cut line. Submitted data would need to include ALL customers that contacted the DNO via this process (non-deselected – see notes). Customers would then be surveyed by the independent survey company.	Not applicable – only inbound customers counted no proactive push from this channel.
Mobile/smartphone app	Similar functionality to the website.	Includes all customers who have opted for further updates on future power cuts when using online power cut checker on mobile. Submitted data would need to include ALL customers that DNO has proactively contacted via this process (non-deselected – see notes).

Notes:

- All outbound channels subject to annual internal (or external ) audit to prevent selective use of channels, i.e.:
  - Use of all channels is not compulsory
  - It is not acceptable to selectively use a channel for certain customers – excluding those who have had a fault a number of times so there is less chance of them being included in the survey
  - Audit would need to ensure that for a sample of faults all customers who were affected (and for whom we had data ) were contacted via that channel (e.g. outbound phone) and a subset were not filtered out
  - It is not acceptable to only selectively invite customers to take part in the survey via Twitter, i.e. all DM’d customers should be offered this

We are willing to discuss these in more detail with Ofgem and to demonstrate how such channels are used in other sectors today.

**Question 4:** *Should the provision of information to connections customers be taken into account when calculating the score of the customer satisfaction survey?*

As currently structured, the survey already includes a question on this topic and therefore customer opinions are already catered for in the survey. Furthermore, this is only one potential driver of customer satisfaction, so to hard-code a specific incentive on this topic risks the BMCS not being fit for purpose should that element drop in importance as a driver of customer satisfaction.

**Question 5:** *Should the number of unsuccessful calls be taken into account when calculating the score of the customer satisfaction survey?*

We support the reintroduction of the incentivisation of the unsuccessful call element of customer service. For the faults part of the incentive, this should be a relatively simple task as DNOs already have recording in place and were incentivised on this until part way through DPCR5. It may also be possible to introduce the incentive to the connections and general enquiries part of the measure – however, DNOs would need to check whether this was technically possible and may need time to amend their telephony systems (or introduce new ones) should their current set not provide this data. The incentive would also need to take into account differing hours of operation of these services between DNOs.

In terms of the potential operation of this element of the incentive, care is needed to ensure that DNOs with different telephony structures are treated equally if this incentive is introduced, and also to ensure that all calls to these lines, whether they are ones that result in a job being sent for surveying or not, are included in the survey.

Based on the benefits of trial periods before the full introduction of the BMCS, should Ofgem decide to introduce an incentive on unsuccessful calls, we support the operation of a trial period for at least a year to help ensure a successful implementation.

The consultation makes no reference to the potential scale of this measure, however we believe that it must be proportionate to the overall BMCS.

**Question 6:** *What indicators should we use to measure complaints performance? How should these be weighted?*

We believe that the current complaints metric is fit for purpose, although there are a small number of improvements that should be made to it.

Our main area of concern is in relation to the current undue weighting given to the Energy Ombudsman element. As highlighted by the GDNs in the RIIO-GD1 work, one decision against the network operator in this area could dramatically affect their allowed revenue – in some cases by a factor far in excess of that appropriate. We support Ofgem's proposal to reduce the percentage weighting of the Energy Ombudsman element from 20 per cent and propose that the new weighting is no higher than 10 per cent. The displaced 10 per cent should be evenly apportioned across the D+1 and D+31 categories – no increase should be made to the repeat complaints category, which is already heavily weighted at 50 per cent.

Ofgem also proposes considering changing the denominator in the calculation of the Energy Ombudsman element of the BMCS so that it is based on the total number of complaints. We support this as it brings it into line with the other elements of the

incentive (D+1 and D+31) and further helps to correct the excessive sensitivity in the current model.

**Question 7:** *How should we calculate the BMCS complaints metric target for RIIO-ED1? How should we calculate the score at which the DNO incurs their maximum penalty exposure?*

It is clear from the 2011–12 return and from the current score that DNOs incur that the maximum penalty (70) is unlikely to be reached. However, before a new score can be proposed, modelling needs to be undertaken once decisions on the other elements of the metric (i.e. those in question 6) are agreed. Furthermore, if possible this decision should be held off until a second year's data is received from DNOs and this data along with the 2011–12 data Ofgem has is modelled using the decisions in question 6.

Please also see our answer to question 6.

**Question 8:** *Do you agree with the proposed approach to assessing stakeholder engagement?*

#### **CHAPTER: Seven Social obligations**

**Question 1:** *Are there additional social issues that the DNOs should address?*

**Question 2:** *Are there any specific outputs that the DNOs could be responsible for delivering?*

**Question 3:** *Should a separate funding allowance be provided to enable DNOs to carry out activities in response to social issues?*

**Question 4:** *Are DNOs adequately incentivised to engage with social issues as part of the BMCS Stakeholder Engagement Incentive?*

UK Power Networks recognises that it has little direct contact with social issues as part of its day-to-day activities. The prioritised use of vulnerable customer registers and ensuring that sufficient support is provided to customers during significant network disruption events, are now the norm across DNOs. However, we recognise that there is a much wider perspective in developing our social and community engagement strategy. It is key that UK Power Networks works with other stakeholders from the industry and representatives of vulnerable and other disadvantaged stakeholders in developing its business strategy. UK Power Networks is supportive of the concept of extending the LCNF bidding approach to cover social issues, i.e. a DNO can bid for funding before starting a project to tackle a social issue. If the rules on this are open enough it can also be future proofed, as the social issues of today are likely to be different to those of 2020.

We note the proposal in paragraph 7.11 of the consultation for automatic EGS payments to Priority Service Register customers. We are supportive of any proposal that would ease the payment to vulnerable customers, but would question whether the use of the Priority Service Register is appropriate, as this includes a wide range of customers who may not necessarily meet all of the social criteria.



## **CHAPTER 8: Connections**

**Question 1:** *Do you consider that our proposed package will drive the appropriate behaviour for connecting both demand connections and generation connections?*

Yes. In general there is a fair balance between promoting effective competition and the market forces within those segments compared with the need to protect customers' interests in the excluded segments and those Relevant Market Segments that have not passed the Competition Test. The balance between DG and demand customers appears to be appropriate.

**Question 2:** *Is it appropriate to remove the DG incentive?*

We agree in general that there is no need for a separate investment incentive for DG connections; as with the demand customer segments, DG customers should be able to benefit from the existing and proposed framework of incentives. The specific application of current and new service incentives is focused appropriately on the higher priority areas for DG customers, namely information and speed of connection. The removal of the DG investment incentive is appropriate.

**Question 3:** *Do you agree that we should split the BMCS customer satisfaction survey into major and minor connections customers?*

Yes. Ofgem's proposal to split the BMCS CSAT survey between major and minor customers seems logical, both in terms of removing the potential bias caused by the uneven weighting of volumes and in opening up the opportunity for a more bespoke approach to large customers/projects. However, we urge Ofgem to consider the introduction of larger sample sizes, and hence to become more reliable in terms of the measure of customer satisfaction.

We support the principle of introducing a separate survey for large customers, subject to:

- addressing the issue of using representative sample sizes; and
- ensuring that the proposed penalties would not apply to those market segments that have not passed the Competition Test provided that the target level of satisfaction is achieved.

**Question 4:** *How should we set targets for the BMCS customer satisfaction survey?*

We believe that, as with the proposed new Average Time to Connect incentive, the BMCS should be DNO-specific with absolute targets.

**Question 5:** *We invite views on our proposals for the Long Term Development Strategy (LTDS), Distributed Generation (DG) Connection Guide and Information Strategy (IS).*

We support Ofgem's proposals. It is important to note that, in addition to the information that customers obtain in a formal quotation, they currently are able to gain information from products such as budget estimates, feasibility studies, capacity reports and access to online information from DNOs' internet sites, including access to "Illustrative Prices", process guides etc. However, we acknowledge that there is scope for improvements in this area.

We support Ofgem's proposal to retain the obligations on DNOs to publish the LTDS and DG Connection Guide. In addition, we are conscious of the need to fully support the development of the low carbon economy and the role that DG connections have to play within it.

We support Ofgem's proposal to incentivise the provision of good quality information. However, it is not clear how the mechanism would operate for factoring 'information performance' into DNOs' overall BMCS score. We believe that other options should be considered – e.g. for those segments that have not passed the Competition Test, it may be more appropriate to apply a separate information incentive linked to customers' responses to a specific set of survey questions, rather than to one general question.

**Question 6:** *Are additional or alternative incentives required to encourage the DNOs to provide better information to connection customers upfront?*

We support Ofgem's proposal to incentivise the provision of good quality information. However, it is not clear how the mechanism would operate for factoring 'information performance' into DNOs' overall BMCS score and we believe that other options should be considered.

**Question 7:** *We seek stakeholders' views on the introduction of a new Average Time to Connect Incentive.*

We support the concept of introducing a new Time to Connect incentive but note that there are two basic options that should be considered fully. The target could be based on:

- average time to connect; or
- percentage achievement of agreed time to connect.

The solution is likely to depend on:

- the volume and variability of the data; and
- the extent to which customers need flexibility in the date of their connections (and not necessarily the earliest possible completion date).

We support the use of exemptions as an acceptable alternative method for addressing the problem of delivery convenience rather than speed; the use of an Average Time to Connect incentive would be acceptable.

Irrespective of which basic measure is adopted, we believe that the mechanism should be based on a number of key principles:

- We agree that the industry, for high volume low cost connections, should be targeted upon the total average time to quote rather than split between the Average Time to Quote and Average Time to Connect. Stakeholder feedback indicates that customers are most interested in the total elapsed time and expect DNOs to manage to this. Furthermore, the elapsed time between the average time to quote and average time to connect, although not directly in the control of the DNO, should not be materially different to the current level of performance.
- We believe that the incentive should be DNO-specific and should be further split between Relevant Market Segments.
- For low volume high cost connections we would propose to move to a % variance to agreed time to connect. Stakeholder feedback strongly suggests that it is flexibility and certainty of delivery that large connections value most. Furthermore, some connection customers do not value speed of connection as they need the connection timescales to fit into a wider programme of work.

- The performance baseline should be the DNO's actual performance in 2012–13 or 2013–14.
- Any ratcheting mechanism should be applied at the mid point of ED1 based on an assessment of actual and potential performance improvements.

Our views are described in more detail at the end of this response in Appendix 2.

**Question 8:** *We seek views on which aspects of service should be measured, the approach used for target setting and whether any exemptions should be applied under the Average Time to Connect incentive.*

We have made proposals for the scope of the incentive and support the use of exemptions to ensure that DNOs' performance is not affected by factors outside their direct control. We strongly believe that the targets should be specific to each DNO.

We also support the retention of guaranteed standards of performance (GSoPs) as a form of backstop to protect customers, and we would expect them to operate effectively in tandem with the current and proposed new incentives.

Of the two options described in paragraph 3.18, it would seem more straightforward – and simpler for the customer – if payments were revised at the end of DPCR5, rather than through a more complicated process of adjusting (and subsequently refining) on the basis of annual inflation forecasts.

**Question 9:** *Do you agree with our proposed approach for the treatment of connection customer contributions by the DNOs during RIIO-ED1?*

We support Ofgem's proposal to the extent that the mechanism would only apply in RIIO-ED1 to those connection assets that do not form part of the DNOs' RAV. We fully support the removal of any disincentives and therefore welcome Ofgem's proposal to align the treatment of high-cost, low-volume projects with that currently applied to high-volume, low-cost connections. However, we believe that the mechanism should only apply in RIIO-ED1 to those connection assets that do not form part of DNOs' RAV, i.e. excluding Sole Use connection assets.

Strategic 'investment ahead of need' would help to improve the timeliness of connections, irrespective of whether it may be required for future demand or DG connection customers. Consequently we would support Ofgem in developing appropriate mechanisms to enable DNOs to make such investments.

The following factors would need to be addressed:

- Who should fund the 'investment ahead of need'?
  - Should it be socialised via DUoS or by future connection customers?
  - If it is the latter, we believe that changes to the ECCR ("Second Comer") Regulations may be required.
- Clearly it will be important to ensure that any changes to the connection charging boundary would be fully aligned with the consequential impacts on DUoS income.
- There may be potential impacts on competition, e.g. a smaller scope of contestable work would be available due to less customer-specific reinforcement.

**Question 10:** *Are additional incentives needed to encourage the DNOs to provide high-quality, timely non-contestable work?*

We note Ofgem's comments regarding quality of connection services; we agree that there is the potential to enhance services to customers in the excluded market segments

but we believe that the progressive development of effective competition in the competitive segments will act as the key driver for improvements to future service/price offerings, based on what customers in those segments require. It is worth noting that competition and choice already exist for many of the Relevant Market Segments, including larger high-value connections, where customers exhibit greater knowledge and purchasing power.

We do not believe that any additional incentives are required over and above those contained in Ofgem's proposals. We believe that:

- The scope of non-contestable activities should erode over a period of time in line with the trend for DNOs to extend contestability over the coming years.
- For those market segments that have passed the Competition Test it should be possible to rely on the timescales prescribed by SLC 15 and not to include any non-contestable elements of work within the BMCS.
- There is potentially an inequitable downside risk for major connections: it is possible that all improvements to enable effective competition may have been made by a DNO by 2015, but if market share does not reduce sufficiently and/or Ofgem concludes for whatever reason that effective competition does not exist, the DNO may nevertheless be exposed unfairly to a penalty.

We note, however, that the real issue in paragraph 8.24 is that DNOs are unable to charge for assessment and design in advance of issuing a quotation (not in advance of the customer accepting it).

The reintroduction of "Upfront Assessment and Design Charges" would make a positive contribution in enabling DNO resources to focus efforts on providing a more efficient and effective quotation service. The scale of work involved in producing a quotation is extensive and involves a series of activities that will include some or all of: enquiry and application processing; site visits; network assessment; technical design and approval; cost estimation; and production of the formal quotation and associated network drawings. Consequently the application of an upfront charge would help to deter many customers from requesting speculative quotations and hence avoid unproductive time and unnecessary costs.

In the longer term, the development of competition may change the dynamics and cause DNOs to consider different offerings. However, we believe that there is a very strong DNO consensus for DECC to enact the revised section 16A of the Electricity Act 1989 (as amended by the Energy Act 2008), and UK Power Networks will seek to demonstrate the necessary evidence.

**Question 11:** *We seek views on the financial exposure and scope of incentives for those market segments that have/have not passed the Competition Test.*

We believe that there is potentially an inequitable downside risk for major connections: it is possible that all improvements to enable effective competition may have been made by a DNO by 2015, but if market share does not reduce sufficiently and/or Ofgem concludes for whatever reason that effective competition does not exist, the DNO may nevertheless be exposed unfairly to a penalty.

Subject to the position in 2014 regarding all DNOs' Competition Test applications, we believe that Ofgem may need to consider the extent to which some elements of some Relevant Market Segments should be re-classified as an Excluded Segment.

We support Ofgem's views that, for those market segments that have passed the Competition Test, no specific incentives are necessary. Furthermore we agree that customers within the excluded segments should benefit from the incentive regime that Ofgem proposes. The precise treatment of Relevant Market Segments that have not passed the Competition Test needs to be clarified, and in our view, penalties should only be applied if performance in any such Relevant Market Segment falls below the agreed target threshold level.

We support the proposals contained in Table 8.3 and believe that the complaints metric should only apply to non-contestable services within Relevant Market Segments that have passed the Competition Test, i.e. it should exclude complaints related to contestable activities.

## **CHAPTER 9: Efficiency incentives and IQI**

**Question 1:** *Do you agree with our proposed range for the efficiency incentive rate?*

**Question 2:** *Do you agree with our proposed approach to the calibration of the IQI?*

**Question 3:** *What are your views on the indicative IQI matrix?*

**Question 4:** *What do you consider are the appropriate rewards for fast-track companies compared to non fast-track companies? Should we have a differential between the two?*

**Question 5:** *Do you agree with our proposals for the same efficiency incentive rate to apply to all areas of expenditure that will be included within the IQI?*

**Question 6:** *Do you agree with our proposed treatment of DNOs within a single ownership group? If you disagree with our proposals in these areas, please explain the basis for an alternative approach.*

UK Power Networks recognises the need to provide appropriate rewards to companies for fast tracking, and the use of a fast tracking IQI matrix is the most appropriate incentive mechanism. For those companies which are not fast tracked but in respect of which Ofgem only has concerns with limited specific elements of their business plans, it would appear appropriate to allow DNOs to benefit from the fast tracking IQI matrix where their plans are approved. However, we recognise that this may introduce additional complexity and therefore, it may be appropriate to introduce a third IQI matrix for companies that are subject to 'other proportionate treatment'.

UK Power Networks agrees with Ofgem's proposal to apply the same efficiency incentive rate to all areas of expenditure included within the IQI. However, we are surprised that Ofgem has included transmission exit charges within the framework. In reality, DNOs have little ability to influence the overall level of spend by the transmission companies. Furthermore, as these companies are governed by a separate price control framework that is just about to be agreed, it is unlikely that customers would benefit from any savings made. Therefore we would propose to keep NGC exit charges outside of the IQI incentive framework.

## **CHAPTER 10: Encouraging innovation**

**Question 1:** *Do you agree that the cap on funding for the electricity NIC should be within the range of £60m and £90m for 2015-16 and 2016-17? Please provide evidence to support your suggested level of funding.*

**Question 2:** *Do you agree that the level of funding for the rest of the ED1 period should be reviewed in 2016 following a review of the LCN Fund?*

**Question 3:** *What are your views on the information DNOs should provide in their innovation strategies? How can DNOs best demonstrate that their approach to innovation is sufficiently well justified and robust?*

**Question 4:** *Do you agree that it would be valuable for DNOs to consult and update their innovation strategies regularly during the price control period?*

**Question 5:** *Are there any aspects of the innovation framework for ED1, which you think should differ from the arrangements from RIIO-T1 and GD1? If yes, please explain why.*

It is appropriate that the innovation framework that Ofgem has developed for RIIO-T1 and GD1 is also implemented in RIIO-ED1. The inclusion of an innovation roll-out mechanism (IRM) is an important addition. UK Power Networks is uncertain that it will be effective in its current form; the allowance of a single window of application appears to be overly restrictive, as do the proposed trigger thresholds of the IRM.

We agree with Ofgem that a review of the effectiveness of the LCNF mechanism and the delivered benefits to customers is needed and it is an appropriate time to do this during late spring 2016. It is UK Power Networks' expectation that it will be able to demonstrate, through its innovation strategy and its well-justified business plan, that a continued investment in innovation will be required throughout RIIO-ED1. Given the inclusion of transmission in the NIC from 2015, it would appear sensible to maintain the level of funding at the higher level for the combined scheme (£90 million), as Ofgem retains the discretion not to allocate the full level of funding if it believes that the proposed projects will not deliver benefits to customers.

UK Power Networks was surprised to see that Ofgem had not set a proposed funding level for the NIC through all of RIIO-ED1 for DNOs. Given the timing of the tipping point of the likely transition to the low carbon economy (towards the end of RIIO-ED1 and at the beginning of ED2), we are surprised that Ofgem sees the balance of probability that the NIC will not be continued beyond 2017. We would have expected Ofgem to include some additional allowance for the remainder of the RIIO-ED1 period, although at a lower rate than RIIO-ED1.

A DNO's innovation strategy is an important foundation of a well-justified business plan. It is important, however, that Ofgem is not prescriptive as to the contents as it is likely that any criteria will act as a barrier to innovation. It is important that the widest possible interpretation of innovation is used to establish whether an innovation strategy is well justified and robust. There are significant uncertainties in delivering an efficient innovation strategy, but it is possible to find underlying patterns of success. Success in innovation is dependent on two key ingredients: 1) technical resources (people, equipment, knowledge etc) and 2) the capabilities in the organisation to manage them. Therefore, although history is not the only determinate of success, those companies that have a good record of delivering innovation are more likely to succeed in the future. It will therefore be important for DNOs to not only identify the opportunities and potential benefits to customers, but also to explain how innovation is managed and, more importantly, deployed back into business as usual.

## Strategy consultation for the RIIO-ED1 electricity distribution price control

### Reliability and Safety

#### Chapter 2 – Overview of Reliability and Safety

**Question 1:** *What are your views on the primary outputs and secondary deliverables for reliability and safety? In particular:*

- (a) Do you agree that these are appropriate areas to focus on?*
- (b) Are there any other areas that should be included?*

We are happy that CIs and CMLs remain as the primary outputs and that Health and Load indices are secondary deliverables and are supportive of the move to a 12 hour guaranteed standard for restoration.

The current IIS mechanism has been successful at driving improved restoration, as a result of the simple, clear incentives it creates. This simplicity should be maintained in the RIIO-ED1 mechanism and we would caution against increasing complexity in areas such as incentive rates or target setting.

We support the separation of planned and unplanned interruptions performance. Planned interruptions allowances should be sufficient to allow companies to carry out their responsibilities safely and efficiently, with a clear incentive to minimise disruption to customers. A responsive rolling target mechanism would enable this and allow for any unforeseen changes that might occur as a result of the roll-out of smart metering.

Companies should still provide forecasts of planned interruptions in their well-justified business plans. These could form the basis of initial targets where they are consistent with historical performance and, combined with a rolling mechanism, would ensure there is no incentive to bid for excessive allowances.

Cut-out failure reporting should be brought onto a common standing with other IIS incident reporting. As there is limited data to set appropriate targets in IIS and uncertainty about the impact of smart meter roll-out on unplanned activity volumes, it should be reported on but remain outside the IIS incentive in ED1.

#### Chapter 3 - Safety

**Question 1:** *What are your views on the proposed primary output and secondary deliverables relating to safety?*

**Question 2:** *Are these appropriate areas to focus on and are there any other areas that should be included?*

We agree that the RIIO-ED1 safety outputs should be focused on legislation compliance and that the HSE should be the primary regulatory body monitoring compliance. The development of an asset health criticality index will provide a suitable secondary safety measure.

**Question 3:** *Do you agree with our proposal not to place a financial incentive on the primary safety output?*

We agree with Ofgem that additional financial incentives are not required as there are other enforcement mechanisms available to the HSE as the industry's primary safety regulator.

We understand Ofgem's position on the reporting of safety information and support developing consistent reporting through the ENA.



**Question 4:** *Do you agree with our proposal to create an incentive framework for secondary deliverables for electricity distribution safety?*

The health indices will include safety impacts as a suitably balanced part of the criticality metric and the incentives, both financial and reputational, on the delivery of these should ensure they are an appropriate output metric. We are comfortable that the ongoing work to develop the Health Criticality Index is giving sufficient weight to the safety related issues.

#### **Chapter 4 – Interruptions Incentive Scheme**

**Question 1:** *Do you agree with our proposal to align the IIS incentive rates with those proposed as part of RIIO-T1?*

**Question 2:** *What are your views on applying the efficiency incentive rate to the IIS incentive rates?*

As Ofgem has commented, the current incentive rates would appear to fall within the range of values Reckon have identified within their literature review. If they also align, post the application of the efficiency factor, with the rates used in the RIIO-T1 energy not supplied incentive, Ofgem should not complicate the mechanism and should continue with a simple set of pre-set incentive rates as in DPCR5.

Applying the IQI efficiency incentive rate to IIS mechanisms will complicate the mechanism, creating a range of incentive rates across the DNOs depending on the IQI rate applied. This could lead to differing 'efficient' levels of service in future.

UKPN has invested significant amount of time and effort in improving its IIS performance during the first two years of DPCR5. The majority of the reduction in customer minutes lost has been driven by improvements in our operational procedures and response (focusing restoring all faults within 12 hours, developing clear customer focused priorities for operational staff and implementing new working and shift patterns to support the first time resolution of faults). This is in contrast to transmission where the majority of the improvements are directly attributable to network investment. Thus the drive to apply the IQI sharing mechanism to the incentive rate is significantly reduced as customers have not contributed directly to the incentive rewards.

We recognise that from Ofgem's analysis that the overall IIS incentive rate is unlikely to change as a result of the combined move to a methodology consistent with transmission and the application of the IQI incentive. Given the effectiveness of the IIS incentive in its current form and the value to customers of a continued improvement in quality of supply performance we believe that Ofgem should retain the current IIS mechanism. If Ofgem does move to the proposed new methodology for calculating the incentive rate then it is important that the overall incentive strength is not diluted as recognised in 4.13.

**Question 3:** *Do you believe we need to introduce a rolling incentive mechanism for IIS, along the lines of the shrinkage rolling incentive proposed in RIIO-GD1, and if so outline your views on the merits of this approach for the IIS?*

While a rolling mechanism, as proposed for RIIO-GD1, creates an incentive for companies to deliver sustained improvements, the RIIO-GD1 proposals create a complex incentive mechanism. The gas proposals introduce a complex true-up process at the end of the regulatory period in addition to a simple in-year incentive similar to that used in the IIS.

As the current IIS mechanism will deliver net benefits to a DNO only if it exceeds its targets on average over the period, we do not understand the need for this complexity and it will not create additional benefits for customers. The established target resetting process, based on upper-quartile CMLs/CIs, encourages companies to look for sustainable means of delivering ongoing performance improvement.

**Question 4:** *What are your views on the level of revenue exposure and do you believe we need to reintroduce a cap on outperformance?*

The overall level of exposure to IIS should be calibrated as part of the package of incentives in RIIO-ED1, particularly if the downside incentive is to be raised to 250–300 RORE bps. We think it unlikely that any DNO would exceed 250–300bps upside in any one year, so the proposals represent an increase in potential downside risk. We recognise that Ofgem is proposing to maintain the protections included in the existing exceptional event mechanisms.

**Question 5:** *Do you agree with our proposal to set separate planned and unplanned interruptions and minutes lost targets under the IIS?*

We agree with splitting unplanned and planned targets and reporting.

**Question 6:** *Do you have a preference amongst the options which we have outlined for planned interruptions and minutes lost target setting in RIIO-ED1?*

A rolling target mechanism that responds suitably quickly to changes in planned interruptions performance removes any incentive to forecast high levels of planned interruptions that would come with company proposed target levels. If companies can justify a higher level of planned interruptions than they are currently forecasting at the beginning of RIIO-ED1 then it may be appropriate to allow companies to start at that level, with the rolling mechanism taking effect after the second year.

With the uncertainty surrounding the impact of smart meter roll-out, a fast responding rolling average (e.g. two years) would offer some protection for the DNO and allow targets to reset to a normal level by the end of RIIO-ED1.

**Question 7:** *Do you have a preference amongst the options which we have outlined for unplanned interruptions and minutes lost target setting in RIIO-ED1?*

A simple rolling best average mechanism could penalise a company for delivering its target performance over the RIIO-ED1 period, and with ongoing recalculation of benchmarks any such mechanism would lead to greater volatility and less clarity of targets, which could harm investment planning.

We prefer that explicit unplanned interruptions targets are set upfront for the RIIO-ED1 period, as this gives companies, customers and stakeholders clarity.

**Question 8:** *Do you agree with our proposals on exceptional events?*

We agree with Ofgem's proposals to continue with the current arrangements, updated to reflect current data for the thresholds. We also agree with the proposals for one-off exceptional events.

**Question 9:** *Do you agree with our proposed approach to smart electricity meters?*

We agree with the approach proposed.

**Question 10:** *Do you agree with us not incentivising short interruptions in RIIO-ED1?*

We are still getting strong feedback from some customer groups about the impact of short interruptions, with questions raised about the three minute threshold. These customers may even be sensitive to transient interruptions or disturbances. We still consider that shortening interruption durations is of benefit to customers but recognise that not all companies are able to measure and target these interruptions effectively. We believe that the three minute element to the CI incentive should remain but that measurement of under three minute interruptions should be part of the reporting framework in RIIO-ED1.

The reporting of short interruptions must be put on a consistent basis across all DNOs for RIIO-ED1, identifying those resulting from transient faults cleared by auto-reclosers and those as a result of automated restoration schemes following permanent faults. UK Power Networks already has the capability to monitor at this level and would propose to do this from the start of the next regulatory year (2013–14). This would build a suitable evidence base to inform future investment and outputs to incentivise interruptions being reduced to as short as is cost-effectively possible in RIIO-ED2.

## **Chapter 5 – Load Indices**

**Question 1:** *What are your views on our proposals on load indices (LIs)?*

Our preference for the measurement of Load Indices is option 2 set out in the paper that is a target with upper and lower bounds. DNOs should not be incentivised to invest money to deliver a specific change in capacity irrespective of the demand that materialises; rather, they should invest so as to manage the level of load to capacity at an appropriate level, which is better represented by option 2. We agree that LI bands should be harmonised.

**Question 2:** *Do you agree with our proposed common LI bandings?*

We agree that a common set of Load Indices should be developed. Ofgem's initial proposals do not appear unreasonable but should be calibrated as part of the ongoing work of the Reliability and Safety Working Group (RSWG) – for example, further work should be carried out to look at whether LI3 should be as narrow a band as 95 per cent to 100 per cent, and whether 24 hours is the right time banding between LI4 and LI5. Our initial view is that this is too short a duration and will lead to too many sites being classified as LI5 where the loading may be within the equipment's short-term capabilities. Further work is required to ensure there are common definitions as to what constitutes around 100 per cent capacity, including short time/dynamic ratings and transfer capacity.

**Question 3:** *Of the two options outlined for determining the LI deliverable, which do you think is the most appropriate?*

Option 2 would be the most appropriate measure for the reasons described above.

Ofgem sets out two options to address delivery performance against the agreed outputs within a distinct price control period. Material under delivery against the LI output target could occur due to timing of delivery for changes in plans due to variations in the development of demand compared to forecasts, as well as failure of the DNO to deliver.

In all cases the most economic path forward may not be served by trying to close a historically forecast gap to an old LI target, so a correction of revenues rather than targets seems the only practical approach. We believe that a DNO should only be penalised where it has failed to deliver the agreed LI output due to factors within its direct control. If Ofgem incentivises the delivery of an absolute LI output target, customers could pay for investment that is not required. We do not believe that this is efficient behaviour.

**Question 4:** *Where significant numbers of substations that predominantly cater for Generation (note the original question says demand) arise, do you agree that the development of a Distributed Generation (DG) index for generation-dominated substations would be feasible and appropriate to implement at the mid-period point of RIIO-ED1?*

We agree that a separate DG index would be appropriate to monitor those substations on the networks where DG connections are constrained due to voltage, fault level or reverse power reasons.

## **Chapter 6 – Health Indices**

**Question 1:** *What are your views on our proposals for health indices (HIs)?*

We are supportive of Ofgem’s proposals for health and criticality.

**Question 2:** *Do you agree with our proposals to introduce criticality into the HI framework?*

We agree that this is an appropriate development for RIIO-ED1. The allocation of risk index categories proposed in the consultation will require review as part of the ongoing work on criticality.

**Question 3:** *Do you agree with our proposals for applying financial consequences in the case of material under or over delivery?*

We agree with including an upside incentive to recognise delivery of asset health benefits beyond the agreed delta where it is in customers’ interests to have done the additional work and it has been carried out efficiently, and maintaining the financial consequences for material under-delivery established in DPCR5.

**Question 4:** *Do you agree with our proposals to require greater consistency in the types of assessments that the DNOs should feed into the calculation of the asset health indices?*

The ongoing work on the Health and Criticality Index will create greater consistency by defining the underlying factors which drive the assessments. DNOs should be able to demonstrate that the framework has been applied in a consistent manner, that the results can be appropriately and independently verified, and that their approach meets good practice standards.

**Question 5:** *What are your views on the suggestion that we would mandate DNOs to develop and maintain HIs in specified asset classes?*

We support extending HIs to other categories where there is suitable supporting information, with the aim of covering the major asset classes where replacement and

refurbishment expenditure is significant. UK Power Networks reports HI information for all current asset classes (there are no HV or LV overhead lines in LPN) except for non-pressurised underground cables. There are still many challenges to developing meaningful measures of asset health for non-pressurised cable systems and collecting condition data, particularly at HV and LV. We are actively looking to derive an output covering civil structures, including substations, enclosures and cable bridges.

## **Chapter 7 – Guaranteed Standards**

**Question 1:** *What are your views on our proposals for the guaranteed standards?*

Overall these are an appropriate set of proposals for RIIO-ED1.

**Question 2:** *Do you feel that we should conduct a mid-period review of the guaranteed standards?*

We do not believe that a mid-period review is necessary. An appropriate framework should be agreed for the RIIO-ED1 period.

**Question 3:** *Do you agree with our proposal to remove the potential double exemption of one-off exceptional events under the IIS and the guaranteed standards?*

We agree that there should be clarity for customers and this will be achieved by removing the exemption. Where an incident is beyond what a DNO should be expected to deliver and is declared as an exceptional event under IIS, then the costs of any payments should be recoverable.

**Question 4:** *Do you agree with our proposal to remove all of the Highlands and Islands customer exemptions?*

We support the underlying principle that has emerged from the 2002 storms and the Dartford incident in 2009 that there should be clarity for customers as to when they will receive a payment.

**Question 5:** *What are your views on our proposal to reduce the normal weather standard from 18 to 12 hours, the associated changes to payment levels and options for funding?*

We support reducing the normal weather standard to 12 hours. If it is not feasible to link the payment levels to inflation throughout the RIIO-ED1 period, we would accept setting the payment level in the middle of the period. We do not consider that this would require any additional funding.

**Question 6:** *Do you agree with our proposal to keep non-domestic customers in the guaranteed standards?*

We have no objection to maintaining payments to non-domestic customers.

**Question 7:** *What are your views on the feasibility and practicality of making payments to all customers automatic?*

It is not yet feasible to make guaranteed standard payments to customers automatically, as we do not have sufficient details of all customers in order to make payments directly to them. This should be considered as further details of the smart meter framework are

understood. This will identify which meters are affected but it is not yet clear if the DNO will have access to customers' details to allow payments to be made to individuals.

**Question 8:** *Do you agree with our proposal to make payments to Priority Service Register customers automatic?*

This would seem to be a reasonable proposal. Given the small numbers of customers affected by specific 12 hour incidents, it should be possible to contact each affected person on our register in order to make payments.

## **Chapter 8 – Worst Served Customers**

**Question 1:** *What are your views on the proposed options that we have outlined for the worst served customers scheme? Please include what you see as the pros and cons of each of the options, whether you have a preferred option and why?*

The current mechanism was targeted at promoting infrastructure improvements to improve service to customers who experience ongoing poor performance where the Customer Interruptions IIS incentive would not be sufficient on its own.

The threshold defining a worst served customer under the DPCR5 mechanism identified very low numbers of customers on our networks in small groups, which in turn generates relatively few schemes that can be achieved within the per customer allowance. However, the scheme could be effective in promoting investment to rectify ongoing issues leading to poor service.

Ofgem has proposed that the value per customer in the current incentive could be reviewed, given suitable evidence, but precludes further consideration of the definition or thresholds applied. If this mechanism is continued (option 1), Ofgem should undertake a wider review of the definition of worst served, as lowering the incident count over three years (to 12, for example) could open up more opportunities for schemes to improve service to those small groups of customers who experience ongoing poor service, at acceptable costs.

The incentive proposal (option 2) is a very different approach which focuses on reducing multiple interruptions in any given year. This has merit if it creates the right incentives to take action more quickly to prevent additional faults. We recognise that the customer interruptions incentive is effective at maintaining overall network resilience but does not target the smaller numbers of customers who have several interruptions in any given year.

Any additional incentive should be complementary to the IIS Customer Interruptions incentive and be targeted at those customers who experience a significant number of interruptions per annum, and a DNO can take proactive measures to manage performance within the year – for example, more than four interruptions.

The incentive is most likely to be effective in incentivising proactive management of defect resolution and more focused tree management, but it is very difficult to see how a

relatively small additional incentive would encourage efficient investment on underground networks such as our London network, where the numbers of customers experiencing more than three interruptions are in orders of magnitude smaller than on networks with overhead distribution systems.

We recommend that the options for this incentive are explored in more detail with the RSWG.

Providing guaranteed standard payments to the worst served (option 3) would recognise the deficiency in service but is unlikely to single-handedly create business cases for improvement in service, and may be best being complementary to one of the other two mechanisms. Customers are unlikely to appreciate any difference between incidents arising from different voltage levels, and systems would have to be put in place for the DNO to identify eligible customers should the standard apply over extended timescales, such as three years.

## **Chapter 9 – Resilience**

**Question 1:** *What are your views on our proposals for network resilience?*

**Question 2:** *Do you think that our proposals cover the right areas or are there other areas that you think we should be considering?*

We agree with the two areas of resilience Ofgem has focused on in the consultation. Other areas of resilience are suitably covered by the IIS framework and Health Index output measures.

It seems sensible to adopt an approach similar to that used in Health Indices to monitor the delivery of flood risk, and this would be an appropriate secondary deliverable output for resilience.

We would also support a simple output metric for the Black Start resilience programme, looking at the number of sites still to be mitigated to the agreed standards.

Reporting alone may be sufficient to drive timely delivery of these programmes, although we do not oppose a small incentive based around the delivery of a DNO's agreed programme as part of the overall incentive package.



## Strategy consultation for the RII0-ED1 electricity distribution price control

### Tools for cost assessment

#### CHAPTER 2: Cost assessment overview

**Question 1:** *Do you consider our overall approach to cost assessment appropriate and what changes, if any, would you propose?*

**Question 2:** *Do you think Ofgem should take into account poor historical performance in its assessment of business plans, and if so, how?*

UK Power Networks has been a very active participant in the ongoing development of the cost assessment framework. The Cost Assessment Working Group (CAWG) has proven to be a useful vehicle for debate. The commitment to early engagement shown by Ofgem has resulted in an approach to cost assessment which is significantly better developed at this point than in previous price controls.

Ofgem's overriding philosophy that a toolkit of methodologies is required to assess the RII0-ED1 business plans is the right one. The range of tools presented at paragraph 2.9 is comprehensive and should ensure that Ofgem is much better placed to deploy an appropriate mechanism for each cost category, rather than the more broad-brush assessments that have been witnessed in the past.

The paper lays out a broad structure to the assessment process in paragraphs 2.10 to 2.15. UK Power Networks is very supportive of virtually all of the proposals described, although we are a little concerned by the use of the upper quartile as the benchmark in all cost assessments. We would suggest that there will be cost categories where it is simply not appropriate to set a benchmark on this basis, and hence Ofgem should be prepared to vary it accordingly.

We note the fact that Ofgem intends to base its benchmarking on three periods of data (2010–2013, 2013–2015 and 2015–2023). This is the right approach as it is generally acknowledged that mixing historical and forecast data is often problematic. However, what is not clear yet is how these three views will be brought together.

UK Power Networks believes that a greater weight should be put on forecast data, as will be clear from subsequent comments.

On the specific question of "poor historical performance", we believe that it is the forecast business plan which should be the primary focus of Ofgem's assessment. If past performance was a bar to fast tracking, for example, then this would remove a powerful incentive on a DNO to submit the most efficient possible business plan. However, that does not mean that historical performance is not important.

A record of poor performance may call into question a DNO's ability to deliver on the promises that they make in their forecast. Hence Ofgem will need to question any substantial step changes in performance and be satisfied that the DNO has a clear strategy, possibly executed in the remaining years of the DPCR5 period, to deliver those performance improvements.

Ofgem indicates that it may implement additional requirements on companies with past performance issues, e.g. higher penalties for failing to deliver outputs. UK Power Networks believes that this would be a pragmatic approach and would have the effect of placing the obligation to deliver squarely on the DNO.

### **CHAPTER 3: Total expenditure analysis and middle-up model**

**Question 1:** *Do you agree with the use of totex benchmarking for RIIO-ED1 and what are your reasons?*

**Question 2:** *Do you agree with the use of a capital expenditure as opposed to capital consumption approach for measuring total costs?*

**Question 3:** *Do you agree with using a similar approach to the top-down model used in RIIO-GD1, considering the adjustment for regional factors, the use of a composite cost driver, and the use of the upper quartile (UQ) to determine efficient costs?*

**Question 4:** *Do you believe it is appropriate to use a middle-up totex model and if so, do you agree with following the principles of the GD1 approach?*

**Question 5:** *What level of disaggregation do you believe is appropriate for the middle-up model to provide a useful comparator to the top-down totex model?*

**Question 6:** *How do you believe lumpy expenditure should be treated in totex modelling?*

UK Power Networks is very supportive of Ofgem's proposal to embrace totex benchmarking as part of the RIIO framework. We believe that this is a major innovation for energy regulation in the UK and will prove to be a significant enhancement to the overall approach to cost assessment.

Our rationale for supporting the use of a totex model is neatly mirrored in paragraphs 3.3 to 3.5 – in fact we would amplify the points made in 3.5 in particular. We have never subscribed to the view that DNOs are identical – for many years companies have made their own choices as to the overall management of their assets. Hence a simple, narrow assessment process would always struggle to reconcile those different choices.

The transition to the low carbon economy will, if anything, make the companies even more divergent in the strategies that they employ – much of that being driven by the nature of their networks and the communities they serve. If an all-encompassing approach such as totex was not required in the past, it most certainly is for the future.

In respect of some of the more detailed questions posed in the document:

We understand Ofgem's proposal to use capital expenditure rather than a capital consumption approach, as there are clearly limitations in respect of the availability of comparable historical data from which to calculate a measure of capital consumption. Looking forward, we suggest that Ofgem should be mindful of the potential virtues of capital consumption and hence should revisit this decision for RIIO-ED2.

The use of capital expenditure within the totex model will require there to be some means of normalising expenditure so that a company is not penalised for being at a point in its investment cycle where significant expenditure is required. The approach used in GD1, where capital expenditure is averaged over seven years, is a pragmatic response to this problem, however Ofgem should consider averaging over a number of periods so as to test the sensitivity to fluctuations associated with investment.

The approach to totex modelling described in question 3 above and paragraph 3.18 appears appropriate. Ofgem is correct to recognise the requirement to adjust the totex cost bases in respect of regional and other company-specific factors. It is also sensible that uncertain elements, such as smart metering costs, are removed. These can be scrutinised separately and incorporated within an uncertainty mechanism, if appropriate.

At this point in time, the middle-up model is still relatively undefined; however, UK Power Networks' preliminary view is that the outline presented in paragraph 3.24 provides a good starting point, and we would be supportive of its inclusion within the framework.

The breakdown of the cost base into five groupings – LRE, NLRE, NOCs, CAIs and BSCs – appears sensible. These are logical groupings which are sufficiently distant from both the totex model and the wholly disaggregated views as to provide a worthwhile contrast.

We would question the potential split of CAIs on the basis of “substantially fixed” and “substantially variable”. All CAIs are variable and will be influenced by the level of activity as well as the scale of the company. If a CAI category was shown to be essentially fixed, we would question whether it should be re-categorised as a Business Support Cost. However, it may be that CAIs should be split into more than one group, in which case Ofgem may wish to consider doing this based on the existence of common cost drivers.

#### **CHAPTER 4: Disaggregated model**

**Question 1:** *Do you believe it is appropriate to use a bottom-up, disaggregated model to compare with the totex model results?*

**Question 2:** *Do you agree with our approach to the disaggregated, bottom-up model?*

Ofgem is correct to dismiss the highly disaggregated model based on “unit costs” mentioned in paragraph 4.8. While unit costs have their place within any assessment process, the attempt to extend this approach across all cost types has been shown to be unrealistic and impractical. The model is also fundamentally flawed as it does not provide a way of taking into account efficient volumes of work required to deliver agreed outputs.

In our view, Ofgem should focus its attention going forward on the bottom-up model described in paragraphs 4.3 to 4.7, comprising a mix of regression and non-regression analysis.

This is a sensible response to the requirement for tools within the cost assessment framework which enable the scrutiny of specific cost categories. It will ensure that Ofgem has a means to test the efficiency of company proposals, using a set of mechanisms that are appropriate to the cost area being assessed.

While supportive of the need for detailed bottom-up assessment, UK Power Networks is wary of aggregating the outputs as a comparison to the totex model.

Ofgem makes reference to the risk of ‘cherry-picking’ in the framework. In a situation where the upper quartile is chosen as the benchmark for bottom-up analysis, any attempt to aggregate the outputs will result in a view of the efficient cost which is likely to be unachievable.

UK Power Networks would propose that Ofgem relies on the totex and middle-up model to guide its overall assessment of the efficiency of a DNO’s proposals and then uses the bottom-up analysis to target specific areas of concern. We would argue that there is no need to aggregate the bottom-up outputs, as the outcomes of scrutiny at this detailed level will ultimately be reflected in the outcomes of the totex and middle-up view. Hence these can operate as complementary assessment processes, rather than Ofgem needing to combine the outputs formally.

#### **Disaggregated unit cost analysis – use as a bottom-up assessment tool**

Firstly, it is plain that, while unit cost analysis has its place in the toolkit, it cannot be applied to the entire cost base and hence any notion that it can provide a total cost benchmark is false.

Secondly, the governance of those aspects of this model which might be taken forward, and used in the wider framework, should follow the same principles as has been agreed for the totex model, with Ofgem providing direction and WPD facilitating.

We set out below our considered views, which expand on the above points but also raise additional items that the industry needs to address and resolve.

#### *Use of unit cost analysis*

UK Power Networks supports the use of unit costs, as a tool for cost assessment, where it is appropriate to do so, but the notion that the entire cost base can be assessed in this manner is, in our view, fundamentally flawed. To be a valid candidate for unit cost analysis, the activity associated with a cost category should ideally be identical across all companies – perhaps possible in a simple manufacturing context, but much less likely in a service environment, such as a DNO. By way of example, a simple UG LV fault is probably one of the better candidates for unit cost analysis, but even this will be impacted by the nature of the surface being excavated and reinstated, the ability to use a machine or requirement to hand dig, the depth of the asset, condition of the asset etc.

The use of unit costs also implies that a suitable cost driver can be identified. As soon as one steps away from high-volume activities, which are essentially similar in scope, it becomes much more difficult to identify a driver. The use of 'actuals' as a driver tells its own story in this respect: that these activities are inherently variable in scope and hence a unit cost approach will not provide a meaningful analysis.

### **CHAPTER 5: Network Investment – Load Related Expenditure**

**Question 1:** *Do you agree with our proposed approach to how the specific building blocks that make up load related expenditure interact as well as which categories are proposed to be included in a load related reopener?*

**Question 2:** *Which of the three options set out for assessing connection-related costs within the price control do you feel is the most appropriate and why? Please reference the following in your answer: d) the gross cost assessment adjusted for net-to-gross ratio or just on the Distribution Use of system (DUoS) funded reinforcement costs e) the most appropriate cost driver for connection reinforcement costs: Meter Point Administration Numbers (MPANs) or number of connection projects f) the most appropriate approach for assessing cost of low volume high cost (LVHC) connections.*

**Question 3:** *Which of the three options set out for assessing wayleaves and diversionary-related costs within the price control do you feel is the most appropriate and why?*

**Question 4:** *For all general reinforcement, is it feasible for the DNOs to provide specific scheme lists based on commonly agreed demand scenarios in RIIO-ED1?*

**Question 5:** *For all general reinforcement, do you think that reinforcement specifically relating to generation should be separately assessed from demand-related reinforcement?*

**Question 6:** *Do you agree with our proposed modelling approach to cost assessment of n-1 reinforcement schemes, specifically in relation to the two proposals for the Load Index (LI) delivery as outlined in Chapter 4 in the „Supplementary annex – Reliability and Safety?*

UK Power Networks agrees with the proposed Load Related Expenditure building blocks presented in figure 5.1 and the accompanying text. We also support Ofgem's proposals on the use of ex-ante allowances, partnered with a load related reopener mechanism.

We support the proposal to socialise reinforcement costs relating to the connection of any DG by domestic consumer classes 1–4. This will address the very real concern that has been expressed by stakeholders – namely that ‘unlucky’ domestic consumers may bear substantial costs resulting from a desire for a domestic-scale DG installation.

UK Power Networks supports Ofgem’s proposed option 3 for the assessment of connections related costs. We would agree that it makes sense to apply a consistent assessment mechanism to reinforcement activities, irrespective of whether they are driven by general demand or specific connections.

We note Ofgem’s point regarding the validity of using exit points as the principal costs driver for connections related reinforcement, although we would make the counterargument that using connections projects is if anything more problematic, as individual projects can vary enormously in scale and complexity. Ofgem might wish to consider running the analysis on both bases, to see whether the choice of cost driver makes a substantial difference to the outcomes of the assessment.

We also wish to point out that a benchmarked approach to reinforcement costs will require appropriate normalisations to be applied, such as regional cost factors, prior to benchmarking.

In paragraphs 5.33 to 5.48, Ofgem describes its proposals for diversions and wayleaves related expenditure. UK Power Networks would agree with Ofgem’s preference for an ex-ante approach while accepting that the level of expenditure does not justify the development of a specific uncertainty mechanism. On that basis, we would support Ofgem’s option 2 in paragraph 5.44. Similarly we agree with Ofgem’s proposals in respect of diversions due to NRSWA.

Ofgem asks specifically whether it is feasible to set unit costs for the conversion of wayleaves to easements and injurious affection payments. It is our view that this may be worth investigating, although we can envisage legitimate reasons why such payments might vary. By way of example, land on the edge of a town might attract a higher premium for conversion to an easement, because of the potential for that to constrain a future change of use of the land. Equally, land values more generally may influence the payments made in a specific area.

Ofgem is correct to point out the potential for a perverse incentive which favours diversions – this is clearly not desirable.

In paragraph 5.49, Ofgem defines general reinforcement as relating to both demand and generation, as well as it including alternatives to reinforcement, such as demand side management. At this point, UK Power Networks is content that general reinforcement is assessed on this basis, although this principle may need to be kept under review during RIIO-ED1, as smart grid technology becomes more mainstream and the balance between generation-led reinforcement and demand-led reinforcement changes. There may indeed be a point where there is more to be learned by separating these drivers.

UK Power Networks agrees with Ofgem’s proposal that n-1 reinforcement should be carried out along similar lines to DPCR4 and DPCR5, as described in paragraph 5.57. The questions as to how much capacity is being added relative to projected demand growth and how much that extra capacity will cost are still relevant, irrespective of the introduction of the Load Index.

We do not agree with Ofgem’s proposal that for general reinforcement it is feasible for the DNOs to provide specific scheme lists based on commonly agreed demand scenarios in RIIO-ED1. Regional load growth for both background and connections activity shows significant variation across the UK. It would not be in the interests of customers or DNOs

to set economic growth at the same level for every network – this would lead to significant under/overinvestment forecasts. However, we recognise that for comparison purposes, Ofgem will require DNOs to model their investment proposals on the same scenarios. Therefore we agree with Ofgem’s overall intention that it should be for companies to produce their company-specific base case plan in conjunction with a common reference scenario such as the “DECC low”.

We welcome Ofgem’s proposal that companies may put forward specific schemes which they expect to be required where demand or generation levels exceed their base forecast. Clearly work will be required to agree the appropriate trigger points for such schemes, however the DPCR5 period has shown the difficulty associated with forecasting. Any mechanisms which enable DNOs to respond more effectively to changes in the external environment are useful.

**Question 7:** *Do you agree that expenditure on secondary network reinforcement is no longer highly correlated with localised economic growth?*

**Question 8:** *Do you believe that it is feasible and appropriate to set definitions and unit cost(s) for the following: d) the conversion of wayleaves to easements and injurious affection payments;*

*e) load related interventions on the secondary network; and*

*f) fault level reinforcement?*

**Question 9:** *What is the most appropriate funding mechanism for load related expenditure on the secondary network?*

We do not agree that expenditure on secondary network reinforcement is no longer highly correlated with localised economic growth. UK Power Networks expects that local economic growth will remain the main determinate of the required level of general network reinforcement in the RIIO-ED1 period. It is only towards 2021 and 2022 that we expect the growth of low carbon technologies to play a more significant part in determining general reinforcement. DNOs will expect to use means of catering for increases in load growth other than the traditional reinforcement, but we do not see these technologies being restricted to just the expected increase in new low carbon technologies (e.g. electric vehicles and heat pumps).

UK Power Networks believes the measurement of interventions on the secondary network/problems to solve is the most appropriate funding mechanism for load related expenditure on the secondary network. We do not believe that it is in customers’ interests to pay DNOs for activities that they have not had to carry out. There is a significant risk of this happening if Ofgem implements option 1 and funds DNOs for megawatts of low carbon technologies added to the network. Where a DNO has significant spare capacity or voltage tolerance on its network, it should use this capacity – at no cost to customers – to deal with the increase in load. DNOs need to be incentivised to avoid network reinforcement wherever possible, and customers should only fund the interventions that DNOs have had to take.

## **CHAPTER 6: Network Investment – Non-Load Related Expenditure**

**Question 1:** *Do you agree with our approach for assessing NLRE in the companies’ business plans?*

**Question 2:** *In light of our proposals, do you agree with our selection of risk removed as the primary output of the mains replacement programme?*

**Question 3:** *Do you agree with our approach to remove non-modelled costs in RIIO-ED1?*

**Question 4:** *Do you agree with our proposed approach for assessing the DNOs’ plans for expenditure on Legal and Safety? If not, what changes would you propose?*

**Question 5:** *Do you agree with our proposed approach for assessing the DNOs’ plans for expenditure on ESQCR? If not, what changes would you propose?*

**Question 6:** *Do you agree with our proposed approach for assessing the DNOs' plans for expenditure on flooding? If not, what changes would you propose?*

**Question 7:** *Do you agree with our proposed approach not to fund Quality of Service (QoS) improvements during RII0-ED1?*

**Question 8:** *Do you agree with our proposed approach to change Black Start and Rising and Lateral Mains (RLM) from reopener mechanisms to ex ante allowances?*

**Question 9:** *Do you agree with our approach to assessing enhanced physical site security costs?*

UK Power Networks supports the broad thrust of Ofgem's proposals in respect of non-load related expenditure. Ofgem is correct to emphasise the responsibility on DNOs to present a comprehensive business case for their forecast expenditure which recognises Outputs at its core, the trade-offs between different asset management approaches and the deployment of cost benefit analysis.

In paragraph 6.7, Ofgem has an expectation that the age-based modelling that it will undertake should provide a medium-term view of replacement needs and offer an upper limit to the level of expenditure required. We share this view and strongly believe in Ofgem's initiatives to encourage DNOs to adopt a more sophisticated approach when choosing asset interventions.

Furthermore we wholly endorse Ofgem's selection of risk removed as the primary output and the use of the criticality approach as a means to add a risk dimension to the asset health index. This will help to ensure that expenditure is being appropriately targeted.

We fully understand Ofgem's desire to expand the use of unit cost analysis to many asset categories that were previously non-modelled. We note the comments in paragraph 6.18 that DNOs will still have the opportunity to present their own justifications for departures from the benchmark and that Ofgem may well retain technical consultants to assist in the analysis of company proposals. UK Power Networks recognises the extra work – both for the DNO and Ofgem – that can result from company justifications and the deployment of consultants. However, we do believe that these are important safeguards as many interventions may not wholly lend themselves to simple unit cost analysis.

We look forward to the early distribution of the age-based model so that we can assist Ofgem in refining it.

UK Power Networks supports the approach proposed for Legal and Safety expenditure. It is appropriate to focus any detailed analysis on the area of site security, where use of unit costs is most relevant. We also welcome the inclusion of metal theft remedial work as a new category of expenditure under this heading.

In respect of the ESQCR, we would support retaining it as a separate category of expenditure within NLRE, reflecting the fact that the rationale for it is different from general asset replacement. Ofgem is correct to note that expenditure should fall away during RII0-ED1, but there will remain a requirement for some level of ongoing expenditure, driven by development in each DNO's region.

Ofgem may wish to consider utilising information from other comparable non-ESQCR schemes (undergrounding, reconductoring etc) to assist in the assessment of the cost effectiveness of a DNO's ESQCR proposals.

Ofgem's suggestion that this area would lend itself to an Output measure is sensible and we would support this.



The proposed approach to flood mitigation appears appropriate. There has been significant effort required to produce the site survey information which will enable us to target this expenditure most efficiently. However, Ofgem is right to expect that this is largely complete by the end of DPCR5 and hence activity during RIIO-ED1 should be squarely focused on delivery of the requisite schemes.

We agree that a whole-life costs approach is the right one, as there are a diverse range of potential mitigations available. Any DNO that suggests a 'one size fits all' approach to flood mitigation has probably not thought deeply enough about the long-term value for money of its proposals.

UK Power Networks would support a performance measure for flood mitigation based on a reduction in risk.

UK Power Networks supports Ofgem's proposals not to provide an ex-ante allowance for Quality of Supply investment.

In respect of DPCR5 non-core reopener costs, UK Power Networks supports Ofgem's proposals to move to ex-ante allowances for expenditure associated with Black Start and rising and lateral mains. We also welcome Ofgem's commitment to provide an ex-ante allowance for enhanced physical site security (previously CNI), where it is possible to do so, with the protection of a reopener mechanism for unforeseen costs.

## **CHAPTER 7: Network Operating Costs**

**Question 1:** *Do you agree with our approach for assessing NLRE in the companies business plans?*

**Question 2:** *In light of our proposals, do you agree with our selection of risk removed as the primary output of the mains replacement programme?*

**Question 3:** *Do you agree with our approach to remove non-modelled costs in RIIO-ED1?*

**Question 4:** *Do you agree with our proposed approach for assessing the DNOs plans for expenditure on Legal and Safety? If not, what changes would you propose?*

**Question 5:** *Do you agree with our proposed approach for assessing the DNOs plans for expenditure on ESQCR? If not, what changes would you propose?*

**Question 6:** *Do you agree with our proposed approach for assessing the DNOs plans for expenditure on flooding? If not, what changes would you propose?*

**Question 7:** *Do you agree with our proposed approach not to fund Quality of Service (QoS) improvements during RIIO-ED1?*

**Question 8:** *Do you agree with our proposed approach to change Black Start and Rising and Lateral Mains (RLM) from reopener mechanisms to ex ante allowances?*

**Question 9:** *Do you agree with our approach to assessing enhanced physical site security costs?*

Trouble call expenditure is a significant element within a DNO's cost base and as such it merits considerable focus within cost assessment. Accordingly the recording of costs and volumes in the RIGs is a relatively detailed process. In light of this, Ofgem is right to attempt to break down the cost assessment into a number of sub-assessments tailored to the nature/volume of the activity and having regard to any issues of data quality.

We have reviewed Ofgem's proposals relating to trouble call, and have the following observations:

- For LV and HV OH and UG faults, we would favour the use of the first option presented, namely regression analysis. It may indeed be possible to undertake this at a more granular level than at DPCR5, but Ofgem should ensure that the regressions are statistically robust. Where statistical testing fails, Ofgem should



aggregate the data to the next level, as this failure is likely to result from boundary issues at the lowest level of disaggregation.

- For EHV and 132kV faults, it is our view that the DPCR5 approach was effective. We are slightly concerned that Ofgem seeks to impose the upper quartile as the benchmark rather than using an average. These incidents are inherently variable in their scale and hence cost. Setting a benchmark based on upper quartile presupposes that a DNO is able to manage the costs down significantly, and may well result in these activities being underfunded.
- For ONIs, in spite of Ofgem's efforts, there is still significant variation between the DNOs in what is reported. For that reason, it is probably prudent to continue with the DPCR5 approach, but the ambition for RIIO-ED2 should be to move to a regression-based approach.
- We support the proposals for third party cable damage recovery.
- We support the continued use of the DPCR5 approach to pressure assisted cables. It is our view that attempting to incorporate this within the LV/HV fault rate assessment would be problematic due to the volatility in costs and volumes associated with this type of asset.
- Likewise we believe that it is sensible to continue with the DPCR5 approach to the assessment of submarine cable faults.

We agree that it is sensible to use the DPCR5 approach in respect of Severe Weather 1 in 20 events.

In our experience, the benchmarking of inspections and maintenance is not straightforward. Such is the diversity and numbers of assets in use that it is problematic to derive any simple metrics.

Ofgem is correct to suggest that reviewing company policies on inspections and maintenance would be a sensible step. This should consider not just the frequency of activity but also the scope. Building on this, the focus should probably be on econometric modelling of the more well-defined, high-volume inspection and maintenance activities. The remaining, more typically low-volume, activities may then merit either specific analysis or an approach based on the lower of average historical actuals and forecasts.

In all analysis of inspections and maintenance Ofgem should avoid the use of spurious unit costs where there is a very small sample of reported costs and/or it is clear that the scope of the activity varies materially between companies and incidences.

Ofgem makes reference to the use of a separate urban specific category of assets in DPCR5. This related to the inspection and maintenance of aspects of the underground infrastructure in London, and specifically the cable tunnel network and forced ventilation systems associated with the major underground installations.

There is a valid debate as to whether these merit a separate categorisation, but what is undeniable is that the inspection and maintenance of such assets needs to be funded. UK Power Networks would be content to discuss its forecast expenditure via a bilateral conversation with Ofgem based on the justification that we provide in our business plan.

The DPCR5 approach to setting allowances for tree management expenditure based on econometric modelling has proved successful and we would support its continuation. We would also support the introduction of the true-up mechanism described in paragraph 7.29

We agree with Ofgem's proposal to apply the approaches used at DPCR5 to the assessment of Dismantlement and Remote Location Generation.

At this time, it is too early to come to a firm conclusion regarding the new approach to substation electricity. In principle, the approach appears sound, but Ofgem has acknowledged that a range of factors including substation size and vertical integration will need to be considered. We would add to this list, consideration as to whether the substation is underground as such sites may require additional electricity to support ventilation and drainage/pumping systems.

As a general point, UK Power Networks believes that company-specific cost factors, such as regional labour and contractor costs, are relevant to the consideration of Network Operating Costs. However, in line with our response to chapter 10, UK Power Networks recognises that the obligation is on us to justify the existence and extent of that impact.

### **CHAPTER 8: Closely Associated Indirect Costs**

**Question 1:** *Do you think that our proposals for the Trouble Call are proportional given the materiality of the area and do you have any preference between the options? Please separate your response by the following categories: low and high voltage overhead faults; low and high voltage underground faults; EHV and 132kV faults; ONIs (formerly non-QoS faults); third party cable damage recovery; pressure assisted cables; and submarine cables.*

**Question 2:** *Do you agree with our approach to assessing Severe Weather 1 in 20 Events and do you have any preference between the options?*

**Question 3:** *Do you agree with our proposed approach for assessing the DNOs plans for expenditure on Inspection and Maintenance (I&M)? If not, what changes would you propose?*

**Question 4:** *Do you agree with our proposed approach for assessing the DNOs plans for expenditure on Tree Cutting? If not, what changes would you propose?*

**Question 5:** *Do you agree with our approach to assessing NOCs Other and do you have any preference between the options? Please separate your response by the following categories: dismantlement, remote location generation, and substation electricity.*

UK Power Networks agrees with the broad approach described for the assessment of CAIs.

The inclusion of Small Tools & Equipment and Network Policy as new cost categories and the consideration of vehicle non-op capex alongside the vehicle opex are all sensible steps.

The regrouping of CAIs is reasonable, although it could be argued that any grouping is essentially arbitrary. For example, on the definitions provided, one could make a case for placing Engineering Management and Clerical Support in either group A or B.

The question as to which cost drivers to apply to these cost groupings is arguably the most difficult to answer. While the criticism levelled at the DPCR5 approach is reasonable, it should be remembered that network investment in particular was chosen as a proxy for the volume of direct activity. If network investment is not used then an alternative measure of work will need to be identified.

While we accept the premise that group A activities substantially vary with activity, we are rather more sceptical of the suggestion that group B activities are essentially fixed. If they are fixed genuinely then they should probably move to Business Support costs. Otherwise both scale and activity will be drivers.

Paragraph 8.17 makes reference to the potential disaggregation of CAIs and then grouping of activities with the same cost driver for assessment purposes. This may prove to be a sensible response to the challenge of identifying cost drivers at the level of the proposed group A or B.

The table below provides some alternative drivers which Ofgem may wish to consider for its disaggregated analysis. Whilst the drivers are up for debate, this attempts to identify where activity and scale are relevant, and the appropriate measure of scale.

<b>Network Design</b>	<b>Driver in disaggregated model</b>	<b>Proposed alternative</b>
Strategic planning of the distribution network	<i>MEAV 2010/11 (WPD Unit Costs)</i>	<i>MEAV</i>
General and Fault level reinforcement	<i>Gross Network Investment, Connections outside price control, DG connections &amp; excluded services</i>	<i>Should be a measure of work; Gross Network Investment, Connections outside price control, DG connections &amp; excluded services (AS PROXY)</i>
Demand connections	<i>Gross Network Investment, Connections outside price control, DG connections &amp; excluded services</i>	<i>Should be a measure of work; Gross Network Investment, Connections outside price control, DG connections &amp; excluded services (AS PROXY)</i>
Relevant Distributed Generation Connections	<i>Gross Network Investment, Connections outside price control, DG connections &amp; excluded services</i>	<i>Should be a measure of work; Gross Network Investment, Connections outside price control, DG connections &amp; excluded services (AS PROXY)</i>
Other Network Investment	<i>Gross Network Investment, Connections outside price control, DG connections &amp; excluded services</i>	<i>Should be a measure of work; Gross Network Investment, Connections outside price control, DG connections &amp; excluded services (AS PROXY)</i>
<b>Project Mgt</b>	<i>Gross Network Investment, Connections outside price control, DG connections &amp; excluded services</i>	<i>Should be a measure of work; Gross Network Investment, Connections outside price control, DG connections &amp; excluded services (AS PROXY)</i>
<b>System Mapping</b>	<i>Length of LV UG Cable</i>	<i>Should be a measure of work; Gross Network Investment, Connections outside price control, DG connections &amp; excluded services (AS PROXY)</i>
<b>EM&amp;CS</b>		
Identification and Implementation of Improvement Initiatives	<i>MEAV 2010/11 (WPD Unit Costs)</i>	<i>Base revenue</i>
Strategic Network Plan Development and Implementation	<i>MEAV 2010/11 (WPD Unit Costs)</i>	<i>MEAV</i>
Work Planning, Budgeting, Allocation and Control	<i>MEAV 2010/11 (WPD Unit Costs)</i>	<i>Number of direct FTEs</i>
Health & Safety	<i>MEAV 2010/11 (WPD Unit Costs)</i>	<i>Number of direct FTEs</i>

	<i>Costs)</i>	
Streetworks Admin: Customer Funded	<i>Demand Connections Expenditure</i>	<i>Should be a measure of work: Demand and DG connections expenditure (AS PROXY)</i>
Wayleaves Payments	<i>Actuals</i>	<i>Not suitable for modelling – lower of historic or actuals</i>
Wayleaves and Easements/ Servitudes: Admin Costs	<i>Wayleaves Payment numbers</i>	<i>Number of wayleaves payments</i>
Clerical Support	<i>MEAV 2010/11 (WPD Unit Costs)</i>	<i>Base revenue</i>
<b>Control Centre</b>		
Outage Planning and Management	<i>Total network length</i>	<i>Should be a measure of activity on network – primarily asset-based be it reinforcement or replacement, as well as connections; Gross Network Investment, Connections outside price control, DG connections &amp; excluded services (AS PROXY)</i>
Real Time Control and Monitoring	<i>Total network length</i>	<i>Should be a measure of activity on network – primarily faults and new connections</i>
Dispatch	<i>Total network length</i>	<i>Numbers of LV and HV faults</i>
Major Incidents & Emergency Planning	<i>Total network length</i>	<i>Not suitable for modelling – lower of historic or actuals</i>
<b>Call centre</b>	<i>Customer numbers 2010/11</i>	<i>Numbers of LV and HV faults</i>
<b>Stores</b>	<i>MEAV 2010/11 (WPD Unit Costs)</i>	<i>Overall activity will drive throughput whilst geography will impact on efficiency of logistics - Gross Network Investment, Connections outside price control, DG connections &amp; excluded services (AS PROXY) combined with Connection Density?</i>
<b>Operational Training</b>		
Classroom training New recruits	<i>Actuals</i>	<i>Number of new recruits</i>
Classroom training Up-skilling	<i>Actuals</i>	<i>Number of staff on formal upskilling programme</i>
Classroom training Operational refreshers	<i>Actuals</i>	<i>Number of new recruits</i>
Classroom training Third parties	<i>Actuals</i>	<i>Number of third party staff</i>
On the job training New	<i>Actuals</i>	<i>Number of new recruits</i>

recruits		
On the job training Up-skilling	<i>Actuals</i>	<i>Number of staff on formal upskilling programme</i>
Classroom training Operational refreshers	<i>Actuals</i>	<i>Number of direct FTEs</i>
Trainer and course material costs (classroom training)	<i>Actuals</i>	<i>Number of direct FTEs</i>
Training Centre and training admin costs	<i>Actuals</i>	<i>Number of direct FTEs</i>
Recruitment New recruits	<i>Actuals</i>	<i>Number of new recruits</i>
<b>V&amp;T</b>	<i>Actuals</i>	<i>Number of direct FTEs</i>
<b>Small Tools</b>		<i>Number of direct FTEs</i>
<b>Network Policy</b>		<i>MEAV</i>

We welcome Ofgem’s continuing commitment to the process of workforce renewal, particularly at a time when the industry is facing significant change, which will further intensify the need to refresh and re-skill the workforce.

Ofgem’s proposed approach whereby companies will in essence need to present a business case for workforce renewal is a reasonable one. We also accept that where DNOs have failed to meet their recruitment targets for DPCR5, then this should be taken account of when setting allowances for RIIO-ED1.

The proposal that a unit cost is set for all apprentice and trainee programmes needs more detailed consideration. This may be a feasible approach to funding such activities; however, it may also fail to recognise specific training needs of individual networks, as well as restricting the opportunities for companies to innovate both in respect of training and wider career development.

We support the assessment and reporting of workforce renewal costs, both as a stand-alone initiative and as part of the wider provision of training (operational and non-operational). We believe that it is correct for the DNOs to look at training and development in a holistic sense.

Finally, we are of the view that Ofgem should make allowances available that will support workforce renewal within the contractor base. The transition to the low carbon economy and the challenge of an ageing workforce will impact equally on these companies. Such are the low margins that are typically available to third party contractors that we believe that many are unlikely to be able to invest in extensive recruitment and training. This situation is exacerbated by the fixed costs that they would have to bear in respect of training facilities, staff etc to support such a process.

The inevitable consequence of this is that contractors will seek to tempt skilled staff from the DNOs, thus driving up wage costs across the sector, and further renewal costs within the DNOs. It is our belief that Ofgem should be encouraging an environment where the pool of labour that is available to the industry can be grown, whether those individuals work for the DNOs or their suppliers.

One option that Ofgem might wish to consider is providing allowances to the DNOs which enable them to expand their training capacity, such that DNOs could offer training services to their third party contractors. Contractors would then put their staff through appropriate training programmes, but without having many of the fixed costs associated.

## **CHAPTER 9: Business Support Costs**

**Question 1:** *Do you agree with our proposed approach to assess CAIs? In particular, do you agree with our groupings of activities?*

**Question 2:** *Are there any views as to which cost drivers would be most appropriate?*

**Question 3:** *Do you believe our approach to assessing Workforce Renewal is appropriate? In particular, do you believe it is appropriate to consider Workforce Renewal allowances both in isolation and also as part of wider training and do you believe Workforce Renewal should include or exclude the training of contractors?*

We are supportive of Ofgem's proposed approach to the assessment of business support costs (BSCs). Ofgem's innovation that DNOs may be compared against other energy networks or comparators from other industry sectors is a reasonable extension of the benchmarking framework.

The cost drivers described in table 9.1 are broadly consistent with what one would expect – the key challenge will be ensuring comparability of cost bases, particularly if companies other than DNOs are to be included.

We have one comment relating to the suggested metric for HR and non-operational training: we assume that this should read Cost per FTE, as non-operational training, which is a significant part of this cost, would typically be received by non-operational (indirect) employees.

We also welcome Ofgem's proposal to continue with the use of expert consultants to review IT & Telecoms and Property Management costs. In both cases we believe that it is important that there is a qualitative dimension to these assessments. In the case of IT&T, it is perfectly possible to define different levels of benefit for different levels of expenditure, and companies should be assessed with that in mind. For Property Management, companies will face different cost implications as a result of the location of their operation, and while this can be managed, there will be a floor to the costs that can be achieved. The scopes of such reviews, as described at paragraphs 9.27 and 9.28, appear sensible.

Ofgem raises the question of how allowances should be set, in the context of a company whose costs are below the benchmark. It is our view that such a company should be allowed the benchmark level of costs, as this would provide a strong incentive to put forward efficient proposals in this area.

Ofgem makes a good point regarding the implications of part-funded connections work carried out by ICPs, and specifically the potential that BSCs may need to be funded, both for the DNO and the ICP.

One issue that Ofgem will have to consider is how best to take account of non-op capex associated with IT&T and Property Management. UK Power Networks supports their inclusion in the assessment of the associated opex categories, but the framework will have to be sufficiently flexible that it can cope with, for example, a need for investment.

We do not agree with Ofgem's proposed approach to assessing the efficiency of company's workforce renewal programmes in DPCR5 and for RIIO-ED1 for the fast tracking process. We would agree that the recruitment of apprentices is one mechanism for replacing retiring employees. However, during the first two years of DPCR5 UKPN has experienced that it is sometimes more cost efficient to up skill existing employees or to

recruit externally and provide additional training specific to the role. We would expect a well run and efficient DNO to replace its work force using the lowest combination of these different recruitment and training methods. Given that all three activities are included within the current work force allowance we would expect that Ofgem should use a combination of all three work force renewal drivers when assessing the efficiency of a DNOs spend.

#### **CHAPTER 10: Regional and company specific adjustments**

**Question 1:** *Do you agree with our general approach to assessing BSCs? If you disagree with any particular areas can you please specify what these are and your reasons?*

**Question 2:** *With regards to the non-fast-track benchmarking, for those DNOs that report lower than the benchmark costs which of the three options for setting cost allowances to you think is most appropriate and why? The options are: increasing allowances to the benchmark level of costs, giving the DNO their submitted level of costs, and taking an average between the benchmark and the submitted costs.*

**Question 3:** *Do you agree with the cost drivers set out for each of the categories of Business Support Costs? If not, can you please suggest an alternative?*

**Question 4:** *Do you agree with the proposed use of expert review to assess IT&T and property costs?*

**Question 1:** *Do you agree with our approach to regional and company specific adjustments?*

**Question 2:** *Which regional and company specific adjustments do you think we should consider in RIIO-ED1? Please give a rationale for your suggestions.*

The RIIO framework places a requirement on network companies that business plans should be "well justified". Paragraph 10.1 clearly articulates the purpose of a company-specific adjustment and the reason why it is necessary if any form of cost benchmarking is to be fair and equitable. However, we do acknowledge Ofgem's desire to avoid a cost assessment framework which is overburdened with such adjustments.

Hence we are of the view that it is reasonable for Ofgem to place the onus on the DNO to propose and evidence any adjustments that they believe may be justified.

UK Power Networks would argue that there are three main factors that a DNO could point to as requiring an adjustment, so as to ensure that any cost benchmarking provides comparable results, namely:

- variation in input prices, which are outside of a DNO's control, e.g. labour and contractor costs
- quantifiable impacts on productivity which result from the operational environment, e.g. very sparse or highly dense areas
- a requirement for the use of assets which are singular to a particular DNO

To elaborate on the above points, UK Power Networks would argue that there is overwhelming evidence of the existence of regional variations in labour and contractor costs – a factor which Ofgem has acknowledged in recent price controls. However, we also recognise that it is reasonable for Ofgem to expect any DNO asking for such an adjustment to demonstrate that they have sought to minimise such issues by relocating staff to lower cost locations where this is practical.

Intuitively, we would suggest that there are specific cost challenges that arise from operating at the extremes of density, i.e. very sparse/remote or very dense/highly urban. Again, we note that Ofgem made allowances for such factors in its recent RIIO-GD1 initial proposals.



Unlike the issue of input prices, where there is plenty of independent, statistical data to draw upon, the impact on productivity will be very much more specific to the company concerned. In such cases the responsibility is unambiguously with the DNO to spell out not only what those impacts might be, but also to do so in such a fashion that Ofgem can readily incorporate those factors into its benchmarking.

There are a number of examples of less common asset types being recognised explicitly in the RIGs, e.g. remote generation, submarine cables, cable tunnels etc. While there may be other assets which are only used by a very small number of DNOs, these are likely to be at the margins – hence we do not foresee any requirement to go beyond what is already captured within the RIGs.

### **CHAPTER 11: RPEs and ongoing efficiency**

**Question 1:** *Are there any additional analytical techniques that we should consider beyond those we have used at past price control reviews to assess RPEs and ongoing efficiency?*

**Question 2:** *Are there any additional data sources that we should be aware of to assist with our analysis of RPEs and ongoing efficiency? Are there some that you think we should rely more on than others?*

UK Power Networks is broadly supportive of the approaches to the calculation of RPEs and ongoing efficiency that are described in the consultation document. It is important that Ofgem use a consistent measure of RPI when calculating RPEs and this measure is reflective of any change to the formula used to calculate RPI.

The one addition that we would make to this relates to the cost of road fuel. In spite of concerted success in recent years in reducing the mileage undertaken as part of company operations, it is still the case that UK Power Networks will spend circa £5 million per year on fuel for its vehicles.

The Department of Energy and Climate Change provides monthly statistics on prices of petroleum products, and while there has been some volatility in recent years, these still show an 18.4 per cent increase in diesel fuel prices as against a 10.2 per cent rise in RPI, during the DPCR5 period thus far (April 2010–October 2012). While the increase in fuel costs is demonstrably greater than RPI, we might have expected to see an even greater rise, in the absence of an economic recession, both as a result of higher demand and proposed increases in fuel duty, which have been deferred in response to the economic conditions.

On that basis, we believe that Ofgem should consider the introduction of an RPE for this essential and material area of costs to DNOs.

One of the challenges of this form of analysis is in extrapolating future conditions from past experience. Hence we would encourage Ofgem to use a diversity of sources and also to recognise that this information needs to be as current as possible. By way of example, our current experience of tendering for overhead capital works is of clear upward price pressure largely driven by the transmission companies mobilising for RIIO-T1. We would suggest that this may be a feature of the early years of RIIO-ED1 as the DNOs attempt to tender for external capability, the supply of which is already constrained as a result of recently let transmission projects.



## Strategy consultation for the RIIO-ED1 electricity distribution price control

### Business plans and proportionate treatment

#### CHAPTER 3: Business plan assessment – process

**Question 1:** *Do you have any comments on the timing and stages of the assessment process?*

**Question 2:** *Do you agree with the three stage assessment process for RIIO-ED1?*

**Question 3:** *Do you think the additional reward for fast tracking is appropriate?*

The form and structure of the RIIO-ED1 price control process are appropriate. We believe that Ofgem has appropriately balanced the time to allow DNOs to develop their business plans and the assessment of these plans. It is important that the assessment process remains proportional to the stage of the process. For the fast tracking process, we believe it is for DNOs to provide sufficient evidence in an appropriate format to enable Ofgem to take a decision on proportional treatment. If a company has not provided this information, or if questions remain about a DNO's business plan, we would expect Ofgem to default companies into the full scrutiny or other proportionate treatment categories.

The proposed changes to the timetable, particularly the use of a single stage fast tracking assessment process, are appropriate. We agree with Ofgem's proposal to implement the licence condition working group in March, after the publication of the strategy decision.

#### CHAPTER 4: Assessment Criteria

**Question 1:** *Does the categorisation of the assessment criteria remain appropriate?*

**Question 2:** *Are there any criteria which we should add or amend in the context of RIIO-ED1?*

The assessment criteria to be used in determining the quality and robustness of company's business plans remain appropriate.

#### CHAPTER 5: Guidance on presentation and structure

**Question 1:** *Is there anything else, in the context of the presentation and structure of the business plan, which we should provide guidance on?*

**Question 2:** *Should we require DNOs to conform to the proposed document structure (set out in figure 4.1), some other prescribed structure, or let the DNOs structure the plans as they see fit?*

**Question 3:** *Should we set a page limit for the executive summary of the plan? How long should it be? Are there other areas where we should consider setting page limits?*

**Question 4:** *Do you agree with the information that we are proposing should be required in each DNO's executive summary? What other information would be useful.*

**Question 5:** *What should be the common metric, calculation and assumptions for determining the impact of the DNOs' proposal on consumer's bills?*

Ofgem's criteria for the assessment of business plans are reflective of the learning from the RIIO-GD1 and RIIO-T1 assessment processes. The additional guidance on the business plan format and the supplementary annexes strikes an appropriate balance between accessibility for stakeholders and flexibility for DNOs in how the information is presented. Stakeholder feedback has also indicated that they require a common format for the presenting of cost and revenue data. UK Power Networks would propose that DNOs and Ofgem agree an appropriate common level of detail to be provided to stakeholders by using the forecast cost and revenue templates in the February strategy decision document.

## **CHAPTER: Six Cost benefit analysis**

**Question 1:** *Do you agree with our proposed approach to cost benefit analysis?*

**Question 2:** *Do you agree with our proposed approach to have a threshold level of expenditure to determine whether cost benefit analysis is required?*

**Question 3:** *What level of expenditure do you believe should be used as the threshold for determining when cost benefit analysis should be provided as part of the business plan submission?*

**Question 4:** *Have we identified all of the relevant parameters to ensure consistency in how cost benefit analysis is undertaken?*

**Question 5:** *What are your views on the levels the parameters should be set at?*

UK Power Networks agrees with the general approach to cost benefit analysis (CBA) being proposed. There should be an appropriate balance between the NPV market value-based societal cost benefit approach and a quantitative but non-monetarised assessment. We understand that the proposed CBA approach was most effective in gas when used in a simple, consistent manner.

The electricity investment plans cover a much wider range of differing assets, so careful consideration is required as to the level it is applied to. We agree that there may be benefit in looking at the major asset classes, particularly where the ED1 programmes are significantly different from historical work volumes.

The electricity distribution work programmes are mainly focused on providing capacity or replacing assets that are in poor condition before failure, because the consequences of failure (e.g. repair time) would be unacceptable.

The use and monetarisation of benefits such as capacity and the value of lost load are essential in order to use CBA in such circumstances. The values used for non-marketed goods and the scope of use of these will need careful consideration and agreement if CBA assessments between DNOs are to be consistent and comparable.

Where models exist that already carry out economic cost benefit of different solutions (e.g. the models around low carbon technologies) and these can be well documented, further simplistic CBA may not add additional value.

The approach may also be less beneficial for long-running high-volume replacement programmes, where delivering a stable investment plan is essential to avoiding peaking workloads and maintaining stable charges to customers.

We agree that there should be a materiality threshold set. Given the scale and scope of electricity investment plans, Ofgem should use its experience from the Gas Distribution process to consider the scope and thresholds together, to ensure the volume of CBA is digestible and informative to Ofgem. Any materiality threshold should be considered and agreed at the cost working group. Based on an eight year price control, it would seem sensible that the threshold for programmes of work is in the order of £15 million–£20 million or £2 million–£3 million per annum. Consideration should be given as to whether this should be the absolute value of work programmes or any increases to established ongoing programmes.

Ofgem has identified the financial parameters necessary. The discounting rates proposed appear sensible. The weighted average cost of capital should be aligned with Ofgem's assumptions for DPCR5 or RIIO-ED1.

As we have already commented, further work is required to ensure that there are consistent parameters for monetarised benefits – for example, the value of lost load. As noted, there is potential for many different assumptions in valuing capacity in reinforcement schemes or loss of supplies in replacement, and Ofgem must ensure there is a consistent framework in place for the use of CBA if it is to be of use in comparing investments as part of the fast track process. We are concerned that differing approaches and values would not be reconcilable in the time available.

## Strategy consultation for the RIIO-ED1 electricity distribution price control

### Uncertainty mechanisms

#### CHAPTER 2: Proposed approach to managing uncertainty

**Question 1:** *Are there any additional criteria that we should take into account to guide the appropriate use of uncertainty mechanisms?*

UK Power Networks believes that it is appropriate for companies to demonstrate within their business plans why any required uncertainty mechanisms are in the interests of consumers and companies.

#### CHAPTER 3: Potential volume driver and reopener and uncertainty mechanisms

**Question 1:** *Do you have any views on the design of the proposed high-volume low-cost connections volume driver?*

**Question 2:** *Do you have any views on the design of the proposed low carbon technologies volume driver?*

**Question 3:** *Do you have any views on the design of the proposed smart meters volume driver?*

**Question 4:** *Do you have any views on the design of the proposed street works reopener?*

**Question 5:** *Do you have any views on the design of the proposed enhanced physical site security reopener?*

**Question 6:** *Do you have any views on the design of the proposed load related expenditure reopener?*

**Question 7:** *Do you have any views on the design of the proposed high value projects reopener?*

**Question 8:** *Do you have any views on the design of the proposed innovation roll out mechanism reopener?*

**Question 9:** *Do you have any views on the design of the proposed pension deficit repair mechanism reopener?*

**Question 10:** *Are there any additional mechanisms that we should be considering? If so, how should these be designed?*

We agree with Ofgem that companies should have a defined window of application for reopeners. The mid point of the RIIO-ED1 period would seem to be appropriate and this should be combined with the mid-period RIIO-ED1 review.

We agree with the scope and mechanisms proposed for most of the areas of uncertainty but have two areas for significant comment. The inclusion of an innovation roll-out mechanism (IRM) and reopener in RIIO-ED1 is an important addition to the framework. UK Power Networks remains unclear that it will be effective in its current form. Further work is needed to develop the criteria as to when the reopener could be used by companies. The allowance of a single window of application appears to be overly restrictive, as do the proposed trigger thresholds of the IRM.

Any uncertainty mechanism should incentivise DNOs to enable the connection of low carbon technologies with the lowest level of network investment. Therefore, it is inappropriate to pay DNOs using a simple volume driver based on the number of low carbon technologies to connect to a network multiplied by an average unit cost. This is not in the long-term interests of consumers as it will reward DNOs for doing nothing in certain network circumstances (i.e. when there is already sufficient capacity headroom in the network).

## **CHAPTER 4: Potential indexation, pass through and trigger mechanisms**

**Question 1:** *Do you have any views on the proposed RPI indexation of allowed revenues mechanism?*

**Question 2:** *Do you have any views on the proposed cost of debt indexation mechanism?*

**Question 3:** *Do you have any views on the proposed pass through of Ofgem licence fees and business rates?*

**Question 4:** *Do you have any views on the proposed tax trigger mechanism?*

**Question 5:** *Do you have any views on the disapplication of the price control process?*

**Question 6:** *Are there any additional mechanisms that we should be considering? If so, how should these be designed?*

The indexation of allowed revenues by RPI remains an important component of the regulated networks price control framework.

The most likely implications of the forthcoming Office for National Statistics (ONS) consultation for Improving the Retail Prices Index (RPI) will result in a significant change to the methodology for calculating RPI which will in turn systematically reduce the level of RPI compared to historical methods of calculation. A realistic scenario suggests a potential 0.9 per cent reduction to RPI outside any movements in the underlying economy, and this would represent a significant reduction in future revenues. This has not been considered in any of the current price control components or risk mechanisms. For electricity distribution operators, the changes would impact the remainder of the current price control period and should be reflected in the uncertainty mechanisms and in the setting of allowances for RIIO-ED1.

We agree with Ofgem that annually setting the cost of debt assumption based on an index is appropriate and provides more certainty to customers and companies. However, we do not believe that the current proposal of using a 10 year rolling weighted average promotes efficient behaviour, as it incentivises companies to take shorter term debt than their asset base would allow and does not allow for the increased issuance costs. As an alternative, we would propose that the index 'trombones' the average so that it moves from a trailing 10 year average to a trailing 20 year average from RY 2012–13 to RY 2021–22 and then holds at a 20 year trailing average going forward. An average of 20 years more accurately matches the life of utility bonds in issue in the IBOXX indexes and preserves some of the history in terms of timing of debt issuance in the past.

## **CHAPTER 5: Mid period review of outputs**

**Question 1:** *Do you agree with the scope of the mid-period review? If not, what changes to the scope are needed?*

**Question 2:** *Do you agree with the indicative process and timetable? If not, how could the process and timetable be improved?*

**Question 3:** *Do you have views on when we should make licence changes as a result of any actions taken at the mid-period review? If a threshold to make a licence change is seen as appropriate, what should this be?*

The inclusion of a 'mid-period' review during the RIIO-ED1 period is important given the level of uncertainty on some output measures, particularly environmental. We agree that this review should be constrained to areas where there have been changes in governmental policy and the introduction of new outputs needed to meet the needs of consumers and other network users. We also believe that it should be extended to allow for the inclusion of learning, particularly implications for the regulatory framework from the DPCR5 Low Carbon Networks Fund review that is to be undertaken in 2016.

## Consultation on strategy for the next electricity distribution price controls –

### RIIO-ED1 - Financial issues

#### CHAPTER 2: Allowed return

**Question 1:** *Is our approach for setting the allowed return appropriate, particularly in the context of an eight-year price control?*

**Question 2:** *What considerations do we need to take into account when setting the notional gearing level?*

**Question 3:** *Is our proposed mechanism for annually updating the cost of debt assumption based on an index appropriate?*

**Question 4:** *Does our range for the cost of equity capture the DNOs' "probable cost of equity in RIIO-ED1?"*

**Question 5:** *Is the ex ante approach to the cost of raising notional equity appropriate for RIIO-ED1?*

The RIIO-ED1 period will cover an increased level of uncertainty with regards to the impact of the connection of low carbon technologies on DNOs' networks, particularly at low voltage. The current proposals for adjusting DNOs' revenues to reflect this uncertainty will not provide sufficient cost and/or price certainty for companies and customers, particularly if there are significant thresholds for reopeners. Initial assessment suggests that risk for RIIO-ED1 is likely to be higher than in DPCR5. Therefore, in practice, while the overall proposed range for the cost of equity is likely to provide a good estimate for RIIO-ED1, point estimates higher than the current DPCR5 allowed rate of 6.7 per cent are likely to be required.

We agree with Ofgem that annually setting the cost of debt assumption based on an index is appropriate and provides more certainty to customers and companies. However, we do not believe the current proposal of using a 10 year rolling weighted average promotes efficient behaviour, as it incentivises companies to take shorter term debt than their asset base would allow and does not allow for the increased issuance costs. UK Power Networks is therefore proposing to modify the cost of debt index to a 'trombone' index where the trailing average increases to 20 years over the next 10 years and then stays at 20 years. A 20 year trailing average would be consistent with companies issuing debt of up to 20 year maturity.

#### CHAPTER 3: Assessing finance ability

**Question 1:** *Have we identified the correct equity and credit metrics?*

**Question 2:** *Do the rating agency credit metric levels quoted provide the most appropriate levels?*

UK Power Networks agrees that the credit metric levels quoted provide the most appropriate guides when assessing financeability. However, Standards & Poor's and Moodys assess companies' net debt position including pension deficit liabilities. This should be taken into account by Ofgem when it assesses DNOs' net debt and when it revisits the allowed pension deficit recovery in RIIO-ED1.

#### CHAPTER 4: Regulatory asset value (RAV), asset lives and depreciation

**Question 1:** *Do you agree with our approach for the calculation of the percentage of totex allowed into RAV?*

**Question 2:** *Do you agree with our revised approach to Totex and with the costs that are included and excluded?*

**Question 3:** *We invite views on whether the definition of related parties should exclude captive insurance companies and whether our proposed approach is proportionate.*

UK Power Networks is supportive of the proposed revised approach for the inclusion of business support costs in Totex in RIIO-ED1. The current treatment as a 100 per cent fast money, 0 per cent slow money split provides an incentive boundary issue for companies and customers. This change will also bring companies much closer to their statutory split of opex and capex.

We have commented previously during the RIIO and RIIO-GD1 and T1 strategy consultations that aligning regulatory and economic asset lives for new assets is appropriate in RIIO-ED1. However, this will not reflect the increased uncertainty on the expected asset lives of new types of network investment to help minimise the decarbonisation of the UK economy. Given that many of these technologies are new and unproven, we would not expect them to last as long as 'traditional' network investment.

## **CHAPTER 5: Taxation**

**Question 1:** *Do you agree with modelling tax under the ASB proposed accounting frameworks for financial reporting in the UK with any changes to be subject to the tax trigger?*

**Question 2:** *We invite views on the calibration of the dead-band.*

**Question 3:** *Do you agree that clawback of the tax benefit of excess gearing in DPCR5 should be spread over the eight years of the RIIO price control? If not, which alternative option do you prefer?*

**Question 4:** *Do you agree that the revenue adjustment for tax clawback should be applied annually as part of the annual iteration process?*

**Question 5:** *Do you agree with our treatment of expenditure for tax modelling including the cash flows of corporation tax payments?*

**Question 6:** *Do you agree with modelling of expenditure subject to capital allowance and capital allowance pool balances?*

**Question 7:** *Do you agree with our proposal for funding business rates?*

UKPN has responded separately to Ofgem on the taxation proposed under RIIO-ED1.

## **CHAPTER 6: Pensions**

**Question 1:** *Do you agree that the fast money true-up adjustments for DPCR5 should be spread over the eight years of the RIIO-ED1 price control if they exceed £1m per DNO? If not, which alternative option do you prefer?*

**Question 2:** *Do you agree with our proposals for the basis for the first and subsequent reset adjustments?*

**Question 3:** *We invite views from interested parties on how we conducted the latest pension reasonableness review, with a view to understanding what elements of the review were conducted well, what could be improved and what should be done differently in future reviews.*

**Question 4:** *We invite views on which of the options for pension scheme administration costs and Pension Protection Fund levies we should adopt; and, if our preferred approach were adopted, the methodology itself, and the level of the de minimis thresholds.*

**Question 5:** *Do you agree that companies must demonstrate a robust approach as to how their de-risking strategies, especially if aggressive, are protecting future scheme funding and that they should clearly demonstrate the benefits that they expect to flow to consumers?*

**Question 6:** *Do you agree that the costs of contingent assets be funded if clearly demonstrated to be in consumer's interests?*

**Question 7:** *We invite views on whether the revised guidance to our pension principles and the methodology is comprehensive and adequate for DNOs and stakeholders to understand how the principles will be applied in RIIO controls and for network companies to prepare their business plan.*

UK Power Networks is pleased to see that Ofgem has reiterated its intent to continue the methodology for RIIO-ED1 that was set out in the DPCR5 final proposals, i.e. the June



2010 pensions principles document and as refined for TIIO in the March 2011 strategy documentation. Certainty of the recovery of pension deficit costs that are outside of the control of the company and are protected by primary legislation is important to network operators, particularly as credit rating agencies rely on this, as they include pension liability costs in the calculation of net debt.

We would propose that, as companies precede through DPCR5, particularly the GAD efficiency reviews and the true-up adjustments for DPCR5, the principles are further documented. We would agree that the true-up mechanism should be recovered across the RIIO-ED1 price control period as long as companies and customers are kept cash neutral to the timing of the recovery.

The first reasonableness review conducted under the DPCR5 framework is yet to formally conclude as Ofgem has yet to provide final clarity to companies on the final outcomes of any proposed adjustments. This will be required before companies can submit final business plans in 2013. As the reasonable review process was undertaken in 2011 and 2012 it was not always clear when Ofgem was progressing between stages. We would propose in future reviews that Ofgem clearly signposts the time period of each stage of review.

UK Power Networks believes that it is appropriate to include the pension protection fund levy and pension scheme administration costs within the efficiency sharing mechanism, as per DPCR5. We also believe that it is appropriate for the settlement to provide a mechanism to adjust for significant changes in the levy, if a given threshold of £1m is exceeded. This will provide certainty for both customers and companies of the recovery of only efficient actual costs incurred through a true-up mechanism. However, we would not agree that companies have influence over these rates of charge.

The application of de-risking strategies to pension deficits is an important tool to enable trustees to ensure that any higher than expected gains through investment strategies are protected. The application of a de-risking strategy should be in the interests of consumers as well as pension scheme members. It is not the role of trustees, who will be making the final decision, to consider the impact on future customers. Companies will have some influence over this decision but they cannot determine the investment strategy for a pension scheme alone. We would therefore not be supportive of the use of retrospective tests to determine whether de-risking strategies were appropriate. We would expect companies to engage with Ofgem when a change in the risk profile of a pension scheme was about to occur and for Ofgem to provide guidance at the time as to whether the scheme was or was not appropriate. If Ofgem believes that the potential benefits of riskier investments is in the long term interest of customers then it would not be unreasonable to expect Ofgem to be able to provide firm commitments to continue to fund deficits if higher risk strategies perform badly.

The DPCR5 agreed pension principles set out how assessing the established deficit should be used to determine if the trusteeship of schemes is reasonable and efficient. We do not see the need for additional tests for specific assets (contingent assets) to be introduced.

## **CHAPTER 7: Annual iteration process for base revenue**

**Question 1:** *We invite views from interested parties on the proposed annual iteration process.*

UK Power Networks has been working with Ofgem to help modify the annual iteration process for base revenue to allow base revenues to be updated during the price control in light of the performance and output levels achieved by DNOs. This will further ensure that companies pay more detailed attention to the development of their business plans.



We are surprised by the scope of the annual iteration process given the timing of the review at the end of November each year (and the subsequent update process), as this will introduce further uncertainty to the level of DUoS prices for our customers over time. We would propose that it would be sensible to introduce a one or two year lag to actual changes in revenues, as Ofgem does for most incentive revenues.