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Dear Cemil,

Developing network monopoly price controls – Ofgem Initial consultation – August 2002

This letter and attachment are submitted on behalf of LE Group in response to Ofgem’s August 2002 Initial Consultation document entitled “Developing network monopoly price controls”. LE Group owns three distribution licensees (DNOs), EPN Distribution, London Power Networks and Seeboard Power Networks. This response is therefore largely related to the Distribution Price Control Review (DPCR), though many of the comments are applicable to all network price controls.

We are pleased to see that Ofgem has taken a holistic approach to the review of network monopoly price controls. In particular we welcome Ofgem’s approach of engaging in early discussions with network operators and other key stakeholders to discuss the objectives, principles and key issues underpinning the review. We support Ofgem’s aim to improve the overall framework and to increase consistency in the approach that is taken in setting price controls between the different network operators. Taken together with the recently established Ofgem-DNO workgroups, this should mean that enduring solutions can be developed that will serve the interests of both consumers and investors.

Our detailed response is contained in the attachment to this letter. I would like to highlight the following points:

- The existing price control framework, incentive regulation based on RPI-X, has worked well in providing companies with incentives to improve efficiency while maintaining a good quality of service.
- The opportunity should be taken to consider further improvements to network monopoly price controls.

- The framework should provide continuing incentives and opportunities for companies to outperform regulatory expectations (i.e. further improve efficiency).
- Companies should continue to be rewarded for being at the efficiency frontier by their being allowed to earn returns greater than the estimated cost of capital.
- An assessment of efficiency should look at outcomes as well as inputs (costs). Long term asset stewardship should be incentivised and rewarded. The recently introduced Asset Management Survey should assist in this area.
- The DPCR is a critical part of Ofgem's work over the next few years and is key to delivering value for money for customers. Consequently this area merits significant Ofgem resource. Ofgem should urgently address its current recruitment difficulties in this area and ensure that sufficient resources are made available over time to address, in an efficient manner, the many issues that are likely to require resolution.

This consultation document is a very good start at identifying the key issues generic to network monopoly price controls and those particular to DNOs. A transparent and achievable timetable set out clearly in advance is a key element in the price control process. The timetable shown for DNOs has little room for slippage. With more policy uncertainties to accommodate than in previous reviews, it is important that Ofgem prioritises its overall work programme so that there is no slippage in the review timetable or in the quality of the work done. The next document should set out Ofgem's thoughts on the key/priority areas for the next DPCR. Our initial thoughts on the priorities are as follows:

- Taking a longer term view – possible use of a longer price control duration and/or a longer term assessment of expenditure coupled with the Asset Management Risk Survey;
- Efficiency of expenditure - in particular, capital expenditure efficiency should be about effectiveness of expenditure not necessarily lowest cost;
- Choosing the right outcomes – need to understand the balance and trade-offs between them;
- Risks - identifying all of the risks involved, where they should be managed and the costs of doing so; and
- Incentive regime - developing a new incentive regime designed to deliver the required outcomes.

If you have any questions about this submission, please contact Tahir Majid on 020 7487 7274.

Yours sincerely

Denis Linford
Group Head of Regulation

Developing network monopoly price controls – Ofgem Initial consultation – August 2002

Wherever possible this attachment uses the numbering and headings in Ofgem's consultation document

Chapter 1 – Introduction

1.6/1.7 Context of this review

Incentive-based Regulation

We agree that:

- The existing price control framework has worked well in providing companies with incentives to improve efficiency while maintaining a good quality of service; and
- It should be possible to introduce further improvements to network monopoly price controls.

However, with respect to the former we believe that there is now limited scope for companies to achieve historic rates of efficiency improvement in the future. Our view is that the existing framework, which has served customers well, requires amendment to ensure that there is a correct balance of incentives and that any perversities are removed. This is vital to ensure that companies invest efficiently to deliver the required outcomes.

There are two key aspects of the existing framework that must be maintained. These are:

- Providing continuing opportunities for companies to outperform regulatory expectations (i.e. improve efficiency) – This will allow investors the short term opportunity to earn a higher rate of return than that assumed by the regulatory cost of capital. In the medium to long term, customers will continue to benefit from lower charges when the efficiencies are shared with customers. This should continue to incentivise Distribution Network Operators (DNOs) to deliver least cost solutions to customers' needs.
- Companies should continue to be rewarded for being at the efficiency frontier – At the last Distribution Price Control Review (DPCR3), companies that were assessed as being at the operating cost frontier were rewarded with a flat operating cost glidepath from the end of the base year and an uplift in allowed revenue. This approach mimics the effect of the most efficient or innovative companies in a competitive environment. In a competitive environment the most efficient/innovative companies earn higher profits, either through greater margins or greater market share until their competitors match that efficiency. Rewarding companies at what is deemed to be the efficiency frontier at a point in time will continue to incentivise all companies to move the efficiency frontier forward, as the

real frontier is unknown and there is still some scope for innovation in the way that companies run their businesses. Continued use of a comparative efficiency assessment coupled with extra rewards for frontier efficient companies should benefit all customers, not just the customers of the most efficient companies, by revealing the efficient level of costs for all companies.

We are also keen to contribute to the debate about ways of reducing the perception of regulatory uncertainty. In addition there is also substantial merit in looking at ways of reducing the risk inherent in the price control process. Ofgem's consultation document is a valuable first step in reducing regulatory risk.

Views of other Stakeholders

The Energy Review by the Performance and Innovation Unit (PIU)¹, the Department of Trade and Industry's (DTI's)² subsequent response, the Energy White Paper (when published), the National Audit Office (NAO) report entitled Pipes and Wires³ as well as the recommendations of the Better Regulation Task Force⁴ should be important considerations in determining the environment under which price controls reviews are undertaken.

The PIU report recognises that regulatory impact on incentives to invest represents one of the most challenging aspects of network regulation. This relates in particular to the regulatory treatment of capital expenditure and the assessment of capital efficiency. Ofgem's consultation is the ideal opportunity to review the existing arrangements and consider whether they are appropriate in the future.

The recent introduction of the Information and Incentives Project (IIP), which incentivises DNOs to improve quality of supply, has been a significant shift towards focussing on outcomes rather than just inputs (costs). This approach may over time address some of the problems inherent in current approaches to assessing operating and capital efficiency, which tend to equate efficiency to lowest cost.

The PIU and NAO reports note the problems of periodicity and short termism inherent in the current five year reviews, in particular the reduced incentives to make efficiency improvements towards the end of the price control period. Both reports discussed the potential use of longer price control periods, whereas the NAO report discusses a number of possible alternatives, including the use of rolling incentives for the duration of the price control period to address this shortcoming. The latter solution provides equally strong incentives to efficiency throughout the price control period. The current price control framework includes a rolling mechanism for capital expenditure.

¹ The Energy Review, A Performance and Innovation Unit Report, February 2002

² Energy Policy: Key issues for consultation, DTI, May 2002

³ Pipes and Wires: Report by the Comptroller and Auditor General, April 2002

⁴ Economic Regulators: Better Regulation Task Force, July 2001

Ofgem should consider these mechanisms. One of the existing Ofgem-DNO workgroups is likely to be the best vehicle to take this issue forward.

Investment decisions in the electricity industry require longer planning time scales than in many other industrial sectors. The industry therefore needs transparency, clarity, and long term consistency in the policy and regulatory framework to enable it to invest efficiently. Regulation should be based on a framework of enduring and well understood principles.

Ofgem's document makes reference to the findings of the Better Regulation Task Force but does not explain how Ofgem intends to incorporate these findings in to the price control review process. This is a significant oversight and Ofgem should consider this issue in more detail. In particular, a key point made by the Better Regulation Task Force is that regulators should provide a thorough analysis of the costs and benefits of significant proposals. This is an essential element of the regulatory process; some prime examples of where Regulatory Impact Assessments (RIAs) should be used include the development of competition in metering and connections. Indeed, Ofwat⁵ recently published guidelines on the use of RIAs. We would expect to see similar guidance from Ofgem in the near future.

Social and Environmental Guidance

Following the government's current Energy Policy review and the future Energy White Paper there are likely to be revisions to the Secretary of State's guidance to the Authority on Social and Environmental policies. This is likely to have a significant impact on the activities of DNOs. In particular, this is likely to strengthen the need for DNOs to facilitate increasing amounts of distributed generation.

Care needs to be taken to ensure that investment incentives are not undermined by too blunt an application of RPI-X economic regulation. The current regulatory framework has successfully revealed short-run efficient cost levels, but we do not consider that it is sufficiently robust to deliver investments necessary for security of supply and long term sustainable outcomes.

Chapter 2 – Ofgem's proposed approach to undertaking price control reviews

2.2 Setting price controls

As we note elsewhere in this response, we support a move to the greater use of outcomes rather than inputs. Consequently, the steps identified in this section should make a more explicit linkage of the identification of the desired outcomes with the resultant level of costs/revenues.

⁵ How we use Regulatory Impact Assessments, Ofwat, July 2002

2.5 Timetable and Consultation Process

Ofgem refers to a number of perceived shortcomings of previous price control reviews. Many of these issues can be overcome through this consultation process and the early commencement of the price control review process.

It is encouraging to observe the manner in which Ofgem has approached the early stages of the consultation process. Ofgem's dialogue with DNOs earlier this year and the recent commencement of the Ofgem-DNO workgroups are important first steps in avoiding many of the shortcomings of the past. This collaborative and early approach to discussing issues will undoubtedly add value to the consultation process and we look forward to contributing to these fora as well as the public workshops and seminars which will be held at regular intervals.

Continued engagement with the companies and other stakeholders will be essential to the development of fully informed views. This engagement should be carried out in a variety of ways:

- Informal correspondence; and
- Bilateral meetings; and
- Workshops and seminars; and
- Working level groups.

However, these fora are not a substitute for the formal consultation process. All the important issues and proposals developed in them must be subject to formal consultation with all interested stakeholders.

A transparent and achievable timetable set out clearly in advance is a key element in the price control process. The timetable shown has little room for slippage. With more policy uncertainties to accommodate than in previous reviews, it is important that Ofgem prioritises its overall work programme so that there is no slippage in the review timetable or in the quality of the work it does. At the last DPCR it was generally recognised that the consultation timescales were too compressed. Therefore, it is essential that sufficient time be allowed to ensure that all responses to a consultation are fully considered before continuing with the next stage of the process. Ofgem's March 2003 principles document should not only establish the main principles of price control reviews but also clearly prioritise the key issues for the next DPCR. The current high level timetable is a welcome first step.

The DPCR is a critical part of Ofgem's work over the next few years and is key to delivering value for money for customers. Consequently this area merits significant Ofgem resource. Ofgem should urgently address its current recruitment difficulties in this area and ensure that sufficient resources are made available over time to address, in an efficient manner, the many issues that are likely to require resolution.

We look forward to supporting Ofgem in its efforts to improve the consultation process. In particular more detailed explanations of the rationale behind major decisions would enhance the consultation process and provide

companies with greater certainty that their views have been appropriately considered. Ofgem should share the following with relevant stakeholders:

- all reports prepared for it by its consultants as part of the price control process; and
- a description of the operation of the existing distribution price control and the process undertaken last time along the lines discussed at the recent Ofgem-DNO incentives group; and
- Ofgem's internal review of lessons from recent price control reviews [par. 1.20].

2.15 Identifying outcomes

Determining what companies are expected to deliver in terms of outputs and outcomes should be agreed through an iterative consultation process. We would support a move towards placing an increasing emphasis on outcomes rather than inputs.

Through previous Ofgem consultation documents relating to the introduction of IIP⁶, Ofgem established selection criteria for defining outcome measures. It is important to establish in advance the criteria for selecting the relevant outcome measures. With this in mind we have attempted to build upon the criteria used by Ofgem for the IIP as follows:

Outcomes should

- reflect what customers value; and
- reflect the government's social and environmental guidance; and
- be attributable to the regulated business; and
- be achievable by an efficient firm but take account of individual circumstances; and
- be simple, easily understood and consistent between firms; and
- be capable of measurement over time.

Outcomes, especially improvements in services to customers should be backed by evidence of customers' willingness to pay for the efficient costs of their provision. It might also be beneficial to consider what outcomes DNOs' customer's (e.g. suppliers and distributed generators) value.

Historically there has been much caution about the measurement of customers' willingness-to-pay for distribution business activities – due largely to the intermingling of distribution and supply activities, the haziness of customers' perceptions, and external influences such as media campaigns.

It is imperative that the paucity of information in this area is addressed as part of the price control process. Therefore, we fully support Ofgem's intention to explore methodologies for assessing consumers' preferences. Such evidence should be unbiased and obtained efficiently. This is best achieved by the full involvement of stakeholders in the development of the scope and

⁶ IIP Update, Ofgem (March 2000)

methodology used to collect the required information. Much work has been done collectively by DNOs in understanding this complex area during the course of and subsequent to Ofgem's IIP consultation. We look forward to contributing to this area through involvement in the relevant Ofgem-DNO workgroup and other forms of consultation.

2.21 Collecting information from companies

Recent steps taken to increase the annual provision of information have been very worthwhile. However the provision of annual information through IIP and regulatory accounts needs further work. We will continue to work with Ofgem to establish these on an ongoing basis.

An important commitment made by Ofgem at the last DPCR was more effectively to collect information from licensees so as to reduce unnecessary burdens on companies. In particular, it is important to reduce the amount of information collected but not used by Ofgem. Currently most Ofgem information requests are not accompanied by an explanation of the use to be made of the information. We support the intention to collect information more effectively, supported by better and more detailed explanations of its use.

2.23 Assessing efficiency and projecting future costs

Traditionally, this has been one of the most contentious areas of the price control process. We believe there is scope for Ofgem to refine and improve the techniques it uses for assessing efficiency.

Risks to adequate investment

The current regulatory framework relies on RPI-X incentives and periodic review of costs, and has successfully revealed short run efficient cost levels. This approach is not necessarily or always sufficiently robust to deliver investments necessary for security of supply and sustainable outcome quality over the longer term. Unless there is clarity about the way in which long and short term outcomes are meant to be achieved and about the way in which investment will be treated by the regulator, there may be a tendency towards under-investment in networks - and quality and security of supply may be impaired. We would note in this context that the PIU review 'has not come to a final judgement concerning the different claims about current levels of investment in networks' (paragraph 4.88).

RPI-X price regulation has provided strong incentives to reduce costs to efficient levels against the background of a relatively inefficient industry at the time of privatisation. It is important to ensure that future costs are not perversely incentivised to fall below efficient levels. In particular, medium to long term outcomes, including security of supply, should not be jeopardised in the pursuit of short-term gain. The greater use of outcomes could reduce the dangers of this undesirable result.

Asset Risk Management surveys

Ofgem mentions the use of the Asset Risk Management survey in helping assess companies' future investment requirements. We welcome the additional attention that is being given to longer term network performance. It

is important that assessments of efficiency as well as of future investment plans are informed by assessments of the adequacy of short and long term asset stewardship.

Current shortcomings

Current shortcomings include the simplistic approach to assessing efficiency primarily on the levels of operating expenditure alone. Consideration should be given to assessing efficiency on the basis of operating expenditure, capital expenditure and outcomes (quality of supply etc). Lowest cost in any one price control period does not necessarily mean most efficient. Rather, efficiency should be defined as delivering the required outcomes at least cost.

Changed circumstances

The shortcomings arising out of changed circumstances include the need for:

- DNOs to facilitate significant amounts of distributed generation including a possible move from passive to active networks; and
- The changing properties of existing incentives as companies approach the efficiency frontier.

It is important not to provide perverse incentives for companies to operate below efficient cost levels. It is equally important to understand efficiency as least cost delivery of a set of outcomes rather than lowest cost without regard for outcomes.

2.26 Developing financial modelling

We are pleased that Ofgem intends to publish details of the financial models with accompanying explanatory guide. This is a welcome development that has already been undertaken by Ofwat for the water industry. It is essential that this type of information be shared with companies and other stakeholders where appropriate. The numbers used for each company in the financial model should be made available to that company. Furthermore, we welcome Ofgem's recent commitment to discuss the financial model via an appropriate Ofgem-DNO workgroup. These discussions should be used by Ofgem to inform its development of the financial model.

We fully support the use of "top-down" financial modelling to augment the "bottom-up" approach to determining allowed revenues. It is important that Ofgem retains a discretionary element to make necessary adjustments to the price control in circumstances that adversely impact on the regulated company. In particular, several DNOs may require an adjustment, or some other regulatory treatment, to their depreciation profile in order to maintain some of the financial indicators at adequate levels.

2.28 Implementing the price control

We agree that drafting of licence conditions should begin well in advance of their date of implementation. Experience from the IIP, where the licence change encompassed complex algebra, suggests that it is in the interests of all participants to review several drafts of the proposed amendments.

2.29 Assessing the review process

We support the idea of publishing a review document after the completion of the price control review to assess the efficacy of the review process. The review process could be further enhanced by the use of a public workshop where interested parties would have the opportunity to share their thoughts on lessons that could be learned for improving future reviews.

As noted earlier, Ofgem should initially share its internal review of the previous price reviews.

2.30 Monitoring price controls

The ongoing monitoring regime is a critical element of the price control process. However, monitoring in the past has operated successfully in the background without requiring excessive and ad hoc intervention. We would support a continuation of this principle.

Chapter 3 – Review of existing network monopoly price controls

3.3 Consistency of price controls

We welcome consideration of greater consistency in the treatment of different network companies at a price control review. However, consistency should not be pursued at the expense of solutions that are necessary to meet the specific or unique circumstances of any one company or set of companies.

3.4 Incentives towards efficiency

As noted earlier, the current regulatory framework has successfully revealed short run efficient cost levels. However, there may be limited future scope to achieve further efficiency improvements. For the next DPCR, there is substantial merit in continuing with incentive regulation, principally by building upon the foundations laid by the existing framework.

The strength and periodicity of incentives

Under the current arrangements there may be weaker incentives to reduce costs and hence operate more efficiently towards the end of a five year price control period. Ofgem should give consideration to strengthening incentives by considering alternative arrangements including the use of rolling incentives or longer review periods. Furthermore, Ofgem should give consideration to assessing costs, in particular capital expenditure, over a longer period than the price control period to provide greater stability and predictability. The longer timeframe is also likely to inform the determination of costs for the price control period.

3.9 The distortion of incentives between capital and operating expenditure

There are greater incentives to reduce operating, rather than capital, costs, though the introduction of rolling five year capital efficiency incentives at DPCR3 was a welcome reduction in this difference. While any difference remains, there is likely to be a continuing difference in the “effort” made by companies in achieving efficient levels of capital versus operating costs and on achieving the most appropriate mix of these costs.

Conversely, as assets are long lived, the benefits to the network of additional expenditure versus avoiding that expenditure may not be apparent until future price control periods. Taking a longer term view of efficient capital expenditure levels may reduce this disincentive to invest.

There can be substitution between operating and capital expenditure. At DPCR3, the two were assessed for efficiency purposes in isolation, with the focus on operating costs; this means that the greatest benefits from being assessed as a frontier company will have been derived from perceived operating cost performance. This approach may distort company decisions about the most appropriate form of expenditure and may even perversely incentivise companies to “redefine” operating expenditure as capital expenditure, though the revised regulatory accounting guidelines may reduce the latter problem. Greater use of a combined operating and capital expenditure efficiency assessment should be considered, though this should also be combined with consideration of outcomes. Furthermore, Ofgem should give consideration to greater rewards for companies on the capital efficiency frontier in the same way that those that are deemed efficient in operating expenditure terms are currently rewarded.

3.12 Assessing efficiency

To date a number of approaches have been used to assess efficiency, sometimes in combination. It is appropriate to revisit these techniques.

Because of the trade-offs and linkages involved, an efficiency assessment should take account of operating and capital costs and outcomes. In the short term, it is unlikely that this assessment of total cost and outcomes (quality) can be carried out in a wholly integrated and deterministic way. However, in assessing the efficiency level of any one factor, Ofgem should be informed by the levels achieved in the other two factors.

The benchmarking of costs against the performance of other companies' performance should aid the assessment of efficiency. However, again it is unlikely, in the short term, that this can be used in a deterministic way. Benchmarking of actual costs is likely to be supplemented by a number of judgements and company specific adjustments to base/normalised costs.

As noted elsewhere, efficiency should also take account of long term asset management issues rather than being focussed only on short term costs and outcomes.

3.14 Incentives to invest and quality of supply

The existing IIP scheme needs to be reviewed to remove the acknowledged deficiencies with it and to further incentivise companies to efficiently deliver the required outcomes over the next review period.

The scheme should be symmetrical and it may be desirable to take a longer term view of targets – investments can often take longer than the price control period to deliver improvements in recorded outcomes. Unless such incentives

are symmetrical there will be an adverse effect on the cost of capital. In reviewing this scheme it is vital that Ofgem takes into account both customers' willingness to pay and the differing marginal cost of improvement that may exist between companies. This will help to ensure that all companies are treated equitably.

As noted earlier, a greater use of outcomes and a longer term view of costs, in particular capital expenditure, may help to reduce any perverse incentives. This should be accompanied by some overall or interdependent assessment of cost and outcomes. The use of the recently introduced Asset Risk Management surveys should also help in this area.

Chapter 4- The next distribution price control review

4.8 Objectives for the price control review

We support the general thrust of these objectives. In this context we should like to make the following points.

- Clearly there is a debate to be had on what is meant by “appropriate incentives”. They should enable companies to meet the financing requirements of efficient expenditure consistent with the risks faced. We take this to mean that DNOs can, at least, expect to recover efficient costs incurred in meeting the obligations that are placed on them during the life of the price control.
- While we are generally supportive of introducing competition into previously monopoly areas and thereby reducing the need for regulation, competition in connections and metering are both contentious areas involving significant costs and risks to DNOs and ultimately customers. Consequently, retention of the final high level objective of ensuring “that competition is promoted in the provision of supply connection and metering services”, should be subject to the test that customers will benefit when all costs and risks are taken into account, as revealed by a Regulatory Impact Assessment (RIA). This would help ensure that Ofgem fulfils its statutory duty to protect the interests of customers. A RIA has not been carried out to date. In the absence of a supportive RIA this objective should be removed from the DPCR’s objectives.
- We support the process related objectives in relation to early resolution of issues and transparency of the review [para 4.11]. As noted earlier, we welcome Ofgem’s steps to date towards the achievement of these objectives. We would like to see similar objectives as a feature of all Ofgem initiatives.

4.13 Dealing with uncertainty

We welcome the recognition of uncertainty as a key issue and support Ofgem’s aims as set out in paragraph 4.20.

Any proposed price control settlement should be examined to see what risks it has for DNOs and customers. The level of risk to be borne by DNOs versus

customers should be established in advance. There are a number of different mechanisms to deal with different types of risk. We look forward to working with Ofgem on the various elements that contribute to DNOs' risk and working out appropriate mechanisms to address all of them.

4.21 Developing the regulatory framework to deal with increased levels of distributed generation

Ofgem lists [para 4.22] a number of developments that will need to be considered. We welcome the specific recognition of the need to look at additional costs and risks in deciding on the appropriate returns and incentives for DNOs. We welcome the intention to set up an Ofgem-DNO workgroup to address distributed generation incentives. Furthermore, we will continue to participate in the various DTI/Ofgem/Industry fora in this area.

4.24 The incentive and price control framework

We note the PIU's comments at paragraph 4.85 that '[an RPI-X scheme] must aim to remove possible distortions, so that companies have broadly the same incentives to invest in quality enhancement investments at different points in the regulatory cycle'. The PIU report also implies that a longer duration for price control could have merit. As noted earlier, Ofgem should consider alternatives to the current five year framework with its reducing incentives through the period.

There has been a considerable period of time since privatisation. It is likely that the industry is fast approaching the point where it will be increasingly difficult to move the efficiency frontier forward. The properties of incentives change as companies approach efficient cost levels. Consequently it is important that companies do not have perverse incentives to operate below efficient cost levels either at the expense of short term or long term outcomes.

There are a number of mechanisms that can reinforce investment signals without distorting RPI-X, including:

- consideration of less frequent reviews and/or use of rolling incentives; and
- a focus on outcomes not inputs; and
- appropriate quality incentives that reward network companies for enhancing standards, alongside penalties for degrading them.

In this context, we particularly welcome the Trade and Industry Select Committee investigation and February 2002 report's conclusions that: 'We are pleased that Ofgem is reviewing the operation of RPI-X and is aware of the need to devise a formula that will give clearer signals to the market about long-term investment. We urge the department and Ofgem to make it a priority to ensure that companies are given sufficient leeway to invest in maintaining and developing a robust energy infrastructure, and to continue to keep under review all the mechanisms available to ensure that there are no regulatory/fiscal disincentives to such investment'.

We are currently considering the pros and cons of a variety of different incentive mechanisms including in relation to distributed generation. As noted elsewhere, we welcome Ofgem's recent announcement of its intention to set up an Ofgem-DNO workgroup specifically to look at distributed generation incentives. We are keen to develop and share our thoughts with Ofgem over the coming weeks.

4.29 DNO outputs [outcomes]

As noted earlier, in our comments on paragraph 2.15, we support an increase in the use of outcomes rather than inputs, accompanied by symmetrical incentives. This would include the use of the Asset Risk Management survey to support Ofgem's assessment of DNOs' efficiency.

Guaranteed and overall standards of performance

The fourth bullet raises the possibility of Guaranteed and Overall Standards (GS and OS) being included in the IIP scheme. The rationale for doing this is not clear. We would welcome clarification from Ofgem in this area. If GS and OS are included in the IIP, it is important that the issue of double jeopardy is addressed. In para 2.30 of the IIP Initial Proposals July 2001, Ofgem stated that the imposition and size of any Utilities Act penalty, relating to a GS or OS failure, would take into account any penalty liable under the IIP for that same failure. Such an approach must continue to apply if the IIP is extended to include GS and OS.

LE Group plc/17.9.02