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Dear Martin

DPCR5 – Looking Ahead

Thank you for the opportunity to comment on Ofgem's initial thoughts on the general approach and key issues for DPCR5. This response is provided on behalf of Western Power Distribution (South West) plc and Western Power Distribution (South Wales) plc.

Context

The context for the next review is likely to be heavily influenced by the forthcoming Energy White Paper and this will distinguish it from past reviews. As the concern for climate change increases, we can also expect to see increasing pressure to move towards a low carbon economy and concern for social and environmental factors increasing.

We recognise that Ofgem must take into account the government's social and environmental guidance and we are particularly interested in the work that needs to be done on distributed generation which we see as a key area for distributors. We welcome Ofgem's ongoing work and initiatives in this area, and if government targets are to be met, the need to ensure that distributed generation is effectively managed is paramount.

Delivery of a simple regulatory framework to facilitate microgeneration and active networks capable of dealing with distributed generation will therefore be a key strategic issue for the next price control review. The framework to support DG must be developed further, with appropriate sustainable incentives to encourage industry players to take action to allow DG to develop. In particular, there will be a need for an enduring technical and commercial framework that does not weaken incentives for industry or customers through unnecessary complexity. Our view is that the key issues are not primarily related to the technical challenges of providing generator connections, but to properly define the role and behaviours of the DNOs in this vital aspect of energy policy development.

Under the Energy Act 2005, Ofgem now has secondary duties including an obligation to carry out its functions in a manner best calculated to contribute to the achievement of sustainable development. Again, it will also be a key activity during DPCR5 to understand how Ofgem interprets this duty and how it intends to translate this into obligations and required behaviours for a distribution business. As proposed in the document, the first step may be to assess the environmental impact of each DNO. We have already discussed with Ofgem the possibility of a “carbon footprint” incentive on our internal operations and would be happy to work with Ofgem on how this can be achieved and how CO² emissions data can be consistently collected across distribution businesses.

Ofgem will need to ensure that its approach to economic regulation supports investment to meet long term environmental policy goals without compromising the principle of ‘arm’s length’ regulation.

Objectives for DPCR5

Ofgem’s stated objectives, to protect the interests of current and future customers by ensuring that the electricity distribution network operators deliver the required outcomes while providing good value for money, are appropriate. The way in which Ofgem takes them into account in its work and decisions should be as transparent as possible.

We are pleased that Ofgem indicates that it remains committed to a system of incentive regulation. WPD support the continued use of the RPI-X price control and we believe that the basic form, structure and scope of the control require little change. In addition we support the extension of RPI-X to provide incentives for specific behaviours such as IIS.

We agree that Ofgem have captured the key strategic issues for the review. We believe the key challenge will be the balance that needs to be achieved between short term cost reductions and long term sustainable solutions for networks.

Roles and responsibilities of electricity distribution businesses

It is apparent that DNOs are facing a large number of new obligations over the next price control period which will have significant implications for costs, and it is important that the price control settlement acknowledges this. There is a potentially a greater role for distribution businesses to play in the future and it will be important for Ofgem to provide clarity about the required outputs from the regulatory contract.

Of particular concern is the approach to be taken in respect of open-wire low voltage overhead lines in proximity to buildings. We are nearing completion of the assessment required by the (then) DTI and have kept Ofgem apprised of the significant estimated rectification costs, which are based on robust and detailed site-by-site information. It will be necessary to agree a programme for this work both with BERR, HSE and Ofgem for inclusion in DPCR5.

Reducing emphasis on 5 year allowances set by the regulator

Whilst we believe it is appropriate for Ofgem to continue to employ a five yearly cycle for reviewing monopoly price controls, we believe that in light of the changing requirements at European and government level it is appropriate to extend the planning horizon significantly beyond five years in order to be able to develop a realistic and viable longer term strategy for networks on key issues such as quality of supply, storms resilience and distributed generation.

We would therefore encourage and welcome the development of the setting out of a long term network strategy that complements and delivers against the governments' stated energy policy and the appropriately researched aspirations of customers. It will also be important to integrate the work that Ofgem is currently undertaking on long term network scenarios into the DPCR5 process.

In order to ensure a robust and accurate outcome of any price review, it is imperative that the data for all companies is compiled on a consistent basis using common definitions before comparisons are made. In addition, in making the comparison the basis of comparison should not only be meaningful but also clearly justified. Therefore, the cost reporting project is a major piece of essential work for Ofgem together with the DNOs and it is imperative that the definitions are as accurate as possible. Accurate comparable data will ensure a more precise and fairer result for future price control reviews.

We acknowledge that significant progress has been made towards achieving this objective in developing the Regulatory Reporting Pack (RRP). However, we are very concerned that there has still been little real progress in assessing comparative efficiency. We have undertaken an extensive amount of analysis of the 2005/06 RRP data and reached the conclusion that data consistency remains a key issue. Multiple examples can be found where the costs reports by a DNO or DNO group are clearly inconsistent with those costs reported by other DNOs. It is essential that greater effort is made by Ofgem to ensure that data is consistent for all DNOs across all activities, not just those that impact on the RAV, and Ofgem should rigorously review each DNO's submission for data inconsistencies.

Climate change and environmental issues

All sectors of the Electricity Supply Industry have a need to consider the long term impacts of climate change on their operations. Consequently there has been widespread support for a co-ordinated and extensive research project with the Meteorological Office to examine impacts on issues such as equipment ratings and overhead line structural loadings for periods extending 30 or more years into the future. The output of this work will facilitate debate with Ofgem, BERR and others into the level of advance investment to mitigate effects. This will result in the need for that debate to enter new territory on the need to engineer in early years, including within the DPCR5 period, to mitigate effects occurring well into the lifetime of the assets in question. It is unlikely that the adoption of a traditional NPV approach would warrant the future resilience investment. Two specific areas of concern being, design loadings for overhead lines and design of substations to mitigate emerging future flood risk

The latter issue of mitigation against current levels of flood risk has of course come into sharp focus during the last month. DNOs, TNOs, Ofgem, BERR and other relevant stakeholders will need to have reasoned discussion and agree common standards to be underpinned by investment plans in DPCR5 and ensuing price reviews. To avoid widely varying approaches in DPCR5 submissions, it is important that these discussions are held soon and common approaches applied.

There has also been a keen interest by Environment Agency (EA) in seeking stated replacement strategies to remove fluid filled cables. Ofgem will be aware of the Memorandum of Understanding (MOU) between the EA and the DNOs /TNOs on the operation of fluid filled cables. The MOU encompasses risk assessment, use of best practices and replacement strategies for fluid filled cables. Given the conflict with existing pollution legislation, the need for compliance with new EU legislation and the consequential tensions and difficulties faced by EA, it is important for the Industry to be sufficiently able to demonstrate to EA that the MOU is working. If EA were to take the view that it was not, the likely result would be withdrawal from the MOU and enforcement action against operators of fluid-filled cables when they leaked. Consequently DPCR5 should address the need for a replacement strategy of fluid filled cables and we believe that measures based both on cable condition and circuit-specific environmental risk, might offer a way forward.

Incentives – potential simplification and sustainability

Ofgem are to be commended on the work on incentives to date as we strongly believe it is the most appropriate mechanism to drive DNO behaviour. There is clear evidence from schemes such as IIS that customers have seen significant improvements in measured performance in areas that are important to them. We therefore believe the current incentives package has largely worked well where the incentive is based on measured outputs that the DNO can control. Ofgem are aware of our concerns over the operation of the losses incentive where the measurement can be influenced by areas outside of a DNO's control such as operation of the settlement system.

The overall objective of an incentive scheme must be to ensure that customers receive both the right service and an appropriate price. A greater engagement with customers and their representatives via detailed research to better understand customer requirements/willingness to pay, together with improvements in reporting standards, are welcome and should increase the scope for further incentives as part of DPCR5 and improve their implementation.

Process – better engagement with consumers and stakeholders, fewer documents

We believe that the open and transparent process adopted for DPCR4 combined with the ability to gain access to Ofgem at all levels, from the analysts to the Authority Committee, was a key determinant in the smooth running of the price control process and we would wish to see this repeated for DPCR5.

The workgroups referred to in the document provide an opportunity to explore new ideas as well as an open channel to discuss issues and problems. We support the ongoing work of these groups in the areas identified and believe that the areas covered have been correctly identified

We welcome Ofgem's early clarification of the timetable and major milestones in DPCR5, but are concerned at the stated intention to reduce the total number of major consultations from seven to four. Our view is that the number of consultations issued during DPCR4 was about right and the response periods specified were sufficient. Ultimately, we can see that fewer documents could be appropriate given the impact of the regulatory reporting pack project, but this would be dependant on the data issues previously referred to being resolved such that all companies' data was on a level playing field. We believe that resolving this issue would allow the number of consultation documents to be reduced from seven to say, five. We are however particularly concerned at the proposal to remove the September update paper. From the timetable included with the annex, this would create a period of almost six months with no direct feedback from Ofgem at a time when DPCR activity is likely to be particularly intense.

As one of the first building blocks to the review it will be important to establish stakeholder's expectations of distributors. In this respect, With regard to assessing customers' willingness to pay, we agree that consumer research needs to be carried out at an early stage in order to identify the outputs that companies are required to deliver and to inform the development of the information request . We recognise that Ofgem intend to use a number of ways to assess consumer "Willingness to Pay", including the use of a consumer survey. However, any survey must be carefully designed to ensure it is statistically robust and that the responses are able to be used as an output in the price control review. To this end we welcome the fact that this work is already underway and that the views of DNOs will be into account in the drafting of the questionnaire, to ensure the validity and reasonableness of the choices offered.

Plans for 2007

The work that Ofgem has carried out so far this year, including the consultation paper, represents a good foundation for DPCR5 and for the development of the existing price control framework and regulatory process to the benefit of all Stakeholders. The early publication of the intended timescale is welcome and it will be important to ensure that this timescale is adhered to.

We would also welcome the early proposal of targets in areas such as Quality of Service, and believe that the information required from each Company to set targets on an equitable basis is already provided via the IIS reporting scheme and through the work of the Quality of Service Group on disaggregation.

Finally, it will be important to build on the work that has already commenced and develop more detailed plans for the whole of the review process. This will allow all the inter-related links to be effectively managed, information to be provided in a clear and timely manner, and clear outputs and objectives to be identified.

I hope our comments are helpful in taking the review forward

Yours sincerely

A handwritten signature in black ink, appearing to read 'AS', with a long horizontal stroke extending to the right.

ALISON SLEIGHTHOLM
Regulatory & Government Affairs Manager