



**Consumer
Focus**
Campaigning for a fair deal

Consumer Focus response to Electricity Distribution Price Control Review Initial Proposals

September 2009

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Executive summary

Consumer Focus broadly supports the key issues outlined in the initial proposals documents and welcomes the opportunity to comment. Our main concerns, issues and observations are:

- The expected average increase of £4 on bills as a result of Distribution Price Control Review 5 (DPCR5) is not unreasonable, given the pressures under which the Distribution Network Operators (DNOs) are set to operate. However, this increase combined with other expected increases in energy bills could potentially contribute to financial hardship for some households, especially the vulnerable and those in fuel poverty
- Consumer Focus would like to see clearer, more frequent and transparent benchmarking of DNOs and publication of annual league tables under the different incentive schemes. There should also be 'end of term reports' on how DNOs have performed as a group and individually, the costs to consumers and the benefits achieved
- We would like to see more detail about how consumer benefits associated with the Low Carbon Networks Fund will be determined or defined and future consideration to DNOs funding a greater share of project costs. We would also recommend that at least one consumer representative is included on the expert panel that will help assess funding proposals and the reward scheme
- While we support the continuation of the losses incentive, we are not convinced that an increase to the value of the losses incentive is necessary or that the benefits should be retained for five years. The existing value of the incentive is an adequate driver of behaviour
- We support the introduction of performance output measures to provide a clearer indication of what DNOs are being funded to perform
- We welcome the new focus on worst-served customers, support the definition of worst-served customer and the introduction use of a 'use it or lose it' allowance. However, we question whether the proposed cap of £1,000 per customer is an adequate amount and recommend that Ofgem review both the way in which the cap is set and the value of the cap before taking final decisions
- At this time we do not support the proposed changes to the guaranteed standards of performance and request Ofgem to undertake further work and consultation on the proposed changes
- We are concerned that consumers may continue to bear the full cost of defined pension deficits during the DPCR5 period and strongly support changes in this area. Please refer to our separate response to the Price Control Pension Principles second consultation for details of our concerns

General comments

While we have some specific concerns with some of the proposals we welcome the electricity distribution price control review initial proposals. We would like to compliment Ofgem on the quality of the initial proposal documents, which provide a coherent set of well-presented proposals. We have found the structure of the documents relatively easy to follow and appreciate the balance between explanation, rationale and detail.

Consumer Focus notes that, as a result of this price control, Ofgem expects that average household electricity bills will increase by less than £4 per year and that proposed annual revenue allowance across the 14 DNO's range from -4.3 per cent to 8.6 per cent. Consumer Focus accepts that real price increases for consumers are probably inevitable given past reductions of DNO revenues and the need to renew distribution systems. We strongly support the need for a range of mechanisms and incentives which will be used to ensure all possible benefits reach consumers, such as the proposed output measures and the incentive associated with the new measure of customer satisfaction.

We are also concerned that, while an average of £4 increase in bills sounds fairly reasonable, this combined with other expected increases in energy bills will inevitably cause increased financial hardship for some households especially for the vulnerable and fuel poor. Ofgem states in its open letter of 4 August 2009¹ that price increases can also be expected for some consumer classes due to the impact of the common distribution charging methodology. In addition, over the price control period other price increases are expected from implementation of smart meters, increases in the renewables obligation and increased Carbon Emissions Reduction Target (CERT) costs.

Ofgem has a duty to protect the interests of current and future energy consumers and we advocate that Ofgem takes these increasing financial pressures as a result of price increases into consideration when determining the profile of allowed increases. It also needs to establish how it will assess going forward the performance of the companies to ensure efficient expenditure is incurred.

It is pleasing that Ofgem proposes to cut company bids by up to 19 per cent bringing the total DPCR5 expenditure to £13bn as we are concerned with the very high levels of revenue requested by the DNOs. However, it is difficult for us however to determine if a 19 per cent cut in bids is reasonable, given the lack of explanation by Ofgem of the reductions it has made.

As we stated in our June consultation response, we acknowledged that continued volatility in the economy has made it more difficult than usual to forecast accurately during this price control review. We also were concerned with the number of unknown factors that could influence DNO performance such as the timing and nature of new investments that might flow from the Government's environmental policies and programmes and, second, how long it might take for the economic recovery to begin. All these factors add to the difficulty in determining if 19 per cent is an adequate cut in DNO bids.

Ofgem notes that, while power prices will increase, 'in return for higher prices, consumers will get better service'. Consumer Focus is keen to ensure that that the increases do indeed result in better service, value for money and real moves towards developing more

¹ <http://www.ofgem.gov.uk/Networks/ElecDist/Policy/DistChrgs/Pages/DistChrgs.aspx>

sustainable networks. There needs to be a clear objective assessment of the extent to which these objectives have been achieved and how.

We continue to have concerns over the ability of DNOs to increase their capital expenditure to the indicated levels given that in DPCR4 DNOs struggled to reach the expected levels of investment.

Ofgem states that it wants shareholders, not customers, to fund investment when companies are not operating as efficiently as the industry leaders. This is something strongly supported by Consumer Focus and the statement needs to be followed through with action to ensure consumers benefit fully from the price control allowances and incentives.

Ofgem proposes that through a number of incentives and obligations behaviour change can be encouraged to accelerate the move to a low carbon economy. We support this aim. The mechanisms proposed include the new low carbon network fund, the losses incentive and the proposals related to distributed generation. We strongly believe the design of these schemes is critical if they are to deliver their desired outcomes (please see our comments below).

The initial proposal documents set out the proposed revenue allowances for each of the 14 DNOs. We have some concerns that, if the assumptions used by Ofgem are inaccurate, the costs passed through to consumers could be significantly different/more than anticipated and that this could lead to increases above the predicted £4 average increase. We acknowledge that under the Information Quality Incentive the DNOs would still benefit and this may help address these concerns. We understand that DNO performance will be monitored and annual reports and a mid-period report will be issued publicly. We look forward to reviewing these reports to help ensure that DNOs performance reflects the agreements made for DPCR5.

The proposed improvements/changes to incentive arrangements are clearly defined and show positive assessments. Each of the change proposals seems to be soundly based given the rationale presented and the impact assessments given. These change proposals could give rise to a marked increase in overall complexity of the regulatory settlement, which we believe should be considered as an issue in its own right as part of the RPI-X@20 review.

We question whether Ofgem has properly addressed the scope for double or multiple awards. For example could a proposal funded under the LCNF also reduce losses and improve a company's interruptions record and therefore increase a DNOs financial reward?

Consumer Focus would like to see clearer, more frequent benchmarking of DNOs and publication of annual league tables under the different incentive schemes. There should also be 'end of term reports' on how DNOs have performed as a group and individually, the costs to consumers and the benefits achieved. We believe that these reports should also be linked to the output measures as it is important that information about output measures are made public. We would support the introduction of a licence condition to ensure DNO's provide the required information in the format stipulated.

Consumer Focus response to key issues

Low Carbon Networks Fund

Previous price controls have focused on understanding DNO costs, working to reduce these costs and using incentives as a means to encourage better service for consumers. As Ofgem states in the initial proposal documents, we now look to their role in terms of low carbon and the needs of current and future consumers which is a realistic and necessary approach. Therefore we support the introduction of the Low Carbon Networks Fund (LCNF) as a one off initiative.

The total amount of £500 million of funding over five years appears to be very generous and we hope that DNO's take this opportunity for funding of testing/piloting innovative network improvements for a low carbon economy. Clear criteria need to be established for applying to claims. It is also important that the fund be promoted among other relevant organisations and consideration given to joint bids between, for example, DNO's and communications companies who specialise in smart grids.

We support work on development of smart grids being funded through the LCNF as this is an important development for the future of a low carbon economy.

We understand DNOs will be asked to fund 10 per cent of qualifying projects and in some cases where there are direct project benefits the DNO funding will form a greater percentage of the cost. We support this approach.

However, we need to see more detail about how the benefits will be determined or defined, what methods will be used to ensure that the DNO who does benefit directly does indeed contribute more funding to the project and how consumers do benefit from the results of successful trials and pilot programs.

If the fund is effective in its purpose, given its generous nature and if the DNOs can readily ascertain the benefits, consideration should be given to DNOs funding a greater component of the project costs – for example 20 per cent or 25 per cent – in circumstances where the expected benefits for consumers are not realised.

We support the proposal that DNOs should be allowed to use any benefits accrued from the project to cover their contribution to the project funding as this will help encourage their participation in this initiative.

Ofgem proposes the establishment of an expert panel to help assess the proposals. We would expect that such a panel would also decide on who receives the discretionary reward/s and would have a least one consumer representative.

Losses incentive

We generally support the revised rules for the losses incentive, including the introduction of a common methodology for reporting losses, a reporting lag for finalised settlement data and a cap and floor on the loss incentive amount.

An incentive to promote a reduction in distribution losses is important and we believe that during DPCR4 this incentive was an effective driver for most DNOs. While we understand how the increase in the incentive value has been calculated, we have concerns that if the incentive value at £48 is an adequate driver of behaviour why this needs to be increased at all.

We believe maintaining a five year retention period is also very generous and this could be reduced without significantly reducing the incentive on DNOs. We support the use of the 2008/09 baseline figures.

Output measures

We support the strong emphasis being placed by Ofgem on output measures throughout the DPCR5 process. Even without the scale of the proposed increases, it is essential that the regulatory settlement is absolutely clear about what customers are to get in return through carefully selected output measures.

We support the proposed common methodology for network output measures. While we look forward to reviewing the guidance document on these measures alongside the final proposals, it would have been useful to be able to provide comment on this document during this stage of the consultation process given the importance of these radically new proposals.

In our June consultation response we expressed concern that output measures might not permit suitable benchmarking. We continue to have those concerns. As mentioned previously we will look forward to the release of DNO performance reports and annual 'league tables' would hope the arrangements can be quickly evolved to help assess DNO performance and welcome the increased transparency that they will provide.

Transmission Exit Charges Incentive

We support the introduction of a 'hybrid approach' for the regulatory treatment of transmission exit charges. Given that all the costs associated with connecting the distribution network to the transmission network are passed through to consumers, we need to ensure DNOs are incentivised to manage these costs efficiently, especially where DNOs can implement their own network solutions rather than rely on the transmission solutions.

Ofgem has proposed to apply a 20 per cent sharing factor on elements that DNOs can influence relative to the allowance for Grid Supply Point (GSP) reinforcements and new GSPs during DPCR5 incurred as a result of DNO requirement. We consider that this figure should be higher in order to provide a more effective incentive.

Worst served consumers and other consumer initiatives

Consumer Focus is pleased that Ofgem continues to focus on creating incentives to improve quality of supply and consider this to be an area of major enhancement in regulatory policies during recent years.

In previous responses we have supported the introduction of an incentive based on a broad measure of customer satisfaction. We agree that DNOs need to be encouraged to pay more attention to consumers' needs beyond issues related to security of supply. We believe that the proposed broader consumer measure that focuses on customer satisfaction, dealing with complaints and stakeholder engagement, will help achieve this aim.

We support most of the other proposed improvements including the introduction of a worst-served customer allowance, a revised interruptions incentive scheme, licence conditions relating to connections service and allowing DNOs to earn a 4 per cent margin to support greater competition in connections.

We are concerned about the proposal to introduce changes to guaranteed standards of performance. Over time we believe that these standards and the subsequent rights of consumers have been gradually eroded. We are concerned that any further changes may continue this trend. We urge Ofgem for further investigation of the impacts of these changes for consumers and consultation with us about the proposed cap and proposed limits.

We welcome the new focus on worst-served customers, support the definition of worst served customer and the introduction use of a 'use it or lose it' allowance. In our previous response we supported the introduction of a cap on the cost per benefitting customer within the worst served customers' mechanism. This was because we believe that without a cap, DNOs could be pressurised by vocal interest groups to divert an unrepresentative amount of resource into a few areas.

We question whether the proposed cap of £1,000 per customer is an adequate amount. The Ofgem documents stated that this figure is based on an average of all projects during the whole period. We are concerned that genuine worst served customers will then have to contribute significant additional funds towards the improvement of their supply or that the work required will not be undertaken. We recommend that Ofgem reviews both the way in which the cap is set and the value of the cap.

We add our concerns to Ofgem's regarding poor service and complaints from consumers regarding connections. We broadly support the initiatives to improve connections service and competition in this area such as the introduction of guaranteed standards and improvements to promote competition. In particular we support the introduction of compensation if customers do not receive connection quotes within a specified timeline and if their connection is not energised within the timeframe agreed with the DNO. We also support the move to stimulate more competition by allowing DNOs to earn reasonable margins on competitive connections activities and to establish tests to determine the extent of competition in each DNO's area. We recommend that Ofgem conduct a review during the control period to assess whether the 'bottleneck'/barriers to entry have been removed.

Consumer Focus response to consultation on electricity distribution price control review initial proposals



If you have any questions or would like further information about our response please contact Abigail Hall, Senior Policy Advocate, by telephone on 0207 799 7934 or via email: abigail.hall@consumerfocus.org.uk.

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Published: September 2009

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