

# DPCR5

Prospect submission to Ofgem consultation on  
Electricity Distribution Price Control Review Initial  
Proposals

Paper Ref: 92/04

Associated documents: 93/09, 94/09 and 95/09

**September 2009**

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## **INTRODUCTION**

- 1.** Prospect is a trade union that represents 102,000 professional, managerial, technical and scientific staff across the private and public sectors. In the utilities sector, Prospect represents engineers, managers and other professionals in the electricity supply industry and increasingly within the gas and water sectors.
- 2.** Prospect welcomes both Ofgem's consultation on Distribution Price Control Review 5 (DPCR5) and our opportunity to comment on policy development.
- 3.** Our submission opens with our views on energy policy (paragraphs 4 to 9), health and safety (paras 10 to 25) and skills (paras 25 to 34) within the context of the price control proposals. It then addresses the other matters raised in Ofgem's policy papers.

## **ENERGY POLICY IMPLICATIONS**

- 4.** Whilst Ofgem is an independent regulator, its initial proposals must be viewed in the context of the Government's energy policy statements. Contradictions between Ofgem's approach to regulation and the thrust of energy policy confuse network operators, other market participants and investors. If left unresolved, such confusion can increase perceptions of risk and deter innovation. Given the significant challenges facing the energy networks, such uncertainty disadvantages consumers by increasing the cost of capital and hampering investment in the industry. For example, Prospect welcomes the intention in the 'UK Low Carbon Transition Plan' that Ofgem's role should include helping tackle climate change and ensuring security of supply. The creation of the £500 million Low Carbon Networks Fund is a helpful measure, commensurate with the projections published by the Energy Networks Strategy Group in March<sup>1</sup>. It would however be helpful to have a clearer indication of eligible expenditure under this fund.
- 5.** Prospect would also caution realism about the preparedness of companies operating in a competitive market to enter into partnerships for Low Carbon Networks Fund projects or to share intellectual property about the outcomes of such projects.
- 6.** It remains Prospect's view that if we are to achieve the wider goals of public policy required for a low carbon economy, regulation must focus more on medium to long-term security of supply and environmental issues and rather less on short-term economics. The fact that no statutory authority has the ultimate responsibility to ensure security of supply often comes as a surprise to those who take a more casual interest in energy policy. Provided the market and regulatory process consistently ensure the right signals are available to investors to bring on new generation, then we may continue to cope without this responsibility being allocated. However it is difficult to rest easy in an increasingly volatile market for energy.
- 7.** Furthermore, the regulatory framework should be flexible enough to encourage investment in network improvements and new generation stations that

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<sup>1</sup> "Our Electricity Transmission Networks: A Vision for 2020' – Report by the Electricity Networks Strategy Group

can clearly demonstrate they will provide system stability to complement and facilitate the connection of more large-scale renewable generation sites to the transmission networks. For example, the 'UK Renewable Energy Strategy' recognises that the implied increase in wind generation could have implications for the security of electricity supply. The regulatory framework will therefore need to be more adaptable and more closely aligned on a practical basis with transmission and distribution companies to enhance awareness of new connections of all types onto the system. The initial proposals do acknowledge the need for companies to take a more holistic view of network costs. This we welcome.

**8.** It is Prospect's understanding that the Government intends to publish a high level vision for a future smart grid later this year. In our view, the adequacy of the Low Carbon Networks Fund will need to be reviewed in the light of this vision and strategy development incorporated into Ofgem's RPI-X@20 report. If, in fact, the timescale for investments extends beyond 2015, any outstanding balance in the Low Carbon Networks Fund should be carried over to the next DPCR period and not lost. Conversely, the initial proposals acknowledge that the pace of change could be faster than anticipated, and that in these circumstances DNOs should be able to approach Ofgem to reset the control. We agree with this, but would emphasise that the regulatory framework should support energy policy development and not inhibit it. So Ofgem will need to be able to respond with some alacrity to such approaches and not take an unduly restrictive or arbitrary approach to allowable costs. We also recognise that the current shortage of professional skills in the industry is a constraint on the improvements that can be realised with existing technology. Given that smart grids require a higher level of analysis of data and enhanced design and control skills, we believe that any assessment of smart grids should consider both skills issues and the recovery of costs associated with smart-metering. We fear that a focus solely on cost would lead to a further round of downskilling in the sector and the loss of the industry's ability to innovate.

**9.** As the 'UK Low Carbon Transition Plan' makes clear, RPI-X@20 must be a comprehensive review covering all networks to make sure the regulatory framework is capable of delivering the networks needed for a low carbon economy. Our expectation is that the Future Electricity Networks team established by DECC will take a proactive approach to reform of the electricity network and that Ofgem will need to liaise closely with this group as well as with other stakeholders, including Prospect.

## **HEALTH AND SAFETY**

**10.** Prospect welcomes Ofgem's development in encouraging the DNOs to ensure "the safety of employees", as well as the public, in the investment and operation of their networks. Prospect has been shaken during the DPC4 period by the increase in fatal incidents to electricity sector employees and contractors. We have previously highlighted our concerns to Ofgem and have referred to the Memorandum of Understanding<sup>2</sup> between Ofgem and the Health and Safety Executive (HSE) that Ofgem's regulatory framework has due regard to the health and safety of "members of the public" and "persons employed in connection with"

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<sup>2</sup> Ofgem/HSE MoU [www.hse.gov.uk/aboutus/framework/f-mou\\_j.pdf](http://www.hse.gov.uk/aboutus/framework/f-mou_j.pdf)

the generation, transmission, distribution or supply of electricity. That Ofgem now seeks to include employees in safety considerations is a step in the right direction. However, Ofgem's Initial Proposals are thin on the policy position in respect of DNO investment in employee safety. Moreover, the proposals suggest limited insight into the health and safety and employment challenges the DNOs face and the significant potential impact of financial incentives on safety performance.

## **The consumer and HSE**

**11.** With the expansion of distributed generation and proposals for improvements from the Low Carbon Network Fund, we believe that the advice and support of the Health and Safety Executive (HSE), with its experience of regulatory enforcement, will be essential. Thus DPCR should recognise the benefits to consumers of allowing charging for HSE advice and safety case assessment to increase HSE resources and accelerate system improvement and connection of distributed generation. Without a charging regime, HSE's very limited resources are likely to become a constraint on change, because the inherently hazardous nature of electricity distribution makes changes to operating practices impractical without a full safety assessment.

## **Health and safety investment & incentives**

**12.** Prospect also welcomes the shift to equalising the incentives for capex and opex. The distortions created by a perception that Ofgem favoured capital investment over operating costs has discouraged behaviour that would extend the life of assets and provided a disincentive to safety improvements.

**13.** We note Ofgem's robust and enthusiastic application of incentives as a mechanism to encourage DNO behaviours promoting outputs for the benefit of the consumer. Throughout the Initial Proposals, Ofgem places a range of incentives on DNOs to innovate and find more efficient ways to provide an appropriate level of network capacity, security, reliability and quality of service. However there appears to be an exception: *workplace* health and safety. No new obligations or incentives apply to what Prospect regards as high priority and no explanations or rationale are provided. This is at odds with the range of issues addressed by the paper and associated documents, all of which attract investment schemes and incentives.

**14.** Prospect has previously highlighted that incentives set by Ofgem overlook their potential for creating disincentives to investment in better health and safety performance. We have suggested improvements. For instance:

- (i) training allowance should include health and safety training and
- (ii) incentives on customer performance should contain some element that relates to the health and safety performance of the DNO.

Our expectations are that in embracing the DNO need to include *employee safety*, Ofgem will link this stipulation to measures that encourage investment and high standards of workplace health and safety. Moreover, our experience of health and safety supported by HSE-approved research shows a close correlation between good safety performance and operational performance. So including health and

safety initiatives within the various incentive schemes, especially those linked to training, is likely to have positive benefits for the consumer.

## **Health and safety challenges**

**15.** Prospect's concerns about the health, safety and well being of people employed in the transmission, distribution and supply of electricity have long been shared with Ofgem. These have arisen from the increase in fatalities, with 2007 being an exceptionally alarming year, and anecdotal evidence from our members and their representatives at the sharp end. Changes to DNO organisational structures have led to leaner staffing levels, intensification of the work for those left in post, reduced training and professional development and a growing skills gap. In short, deteriorating conditions within the industry are increasing the risks of accidents and ill health.

**16.** Growing evidence from international research shows that organizational change can adversely impact on worker health, safety and well-being. Perceptions of growing workload and reduced job security are associated with rising levels of mental ill health such as stress, depression and anxiety, while low levels of control and high demands are associated with a greater risk of cardiovascular disease. So significant is the problem, that workplace health and well-being have steadily risen up the agenda of the UK Government and businesses as they recognise the threat to the health of the nation of growing levels of absenteeism associated with workplace psychosocial risks. Indeed the Department for Work and Pensions has said "neither our economy nor our society as a whole can afford to stand back and allow people to be written off." In an industry that has experienced wave after wave of change since privatisation, combined with price reviews that have overlooked worker health and safety, it comes as no surprise to Prospect that hard evidence is now emerging of what we have long been anecdotally reporting.

**17.** In August 2009 the Energy Networks Association released their 8<sup>th</sup> annual "SAFELEC" Progress Report<sup>3</sup> (for the period January - December 2008), charting the electricity industry's progress towards meeting the Government targets set out in their June 2000 strategy documents "Revitalising Health & Safety" and "Securing Health Together". The report reveals increases in work-related ill health, including an almost quadrupling in the incidence rate of stress-related sickness absence in 2008 from the previous year.

**18.** Whilst health and safety is regulated by HSE, Prospect believes that Ofgem should consider the impact of this evidence on industry performance and customer service. It echoes deterioration in health and safety performance in the rail industry, where fragmentation of the industry undermined organisational relationships, support and role clarity, affecting areas of work design associated with poor health and well-being, lower productivity and increased sickness absence if poorly managed. Indeed, in rail, the health and safety regulator reappraised their safety case processes to address the emerging risks and there was a substantial increase in public subsidy to reflect the need to reverse the trends. Whilst Prospect does not see any need to merge safety and economic regulation in electricity distribution, the process that led to a combined regulator

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<sup>3</sup> SAFELEC 2010 [www.energynetworks.org/spring/she/pdfs/safelec/SAFELEC\\_8th.pdf](http://www.energynetworks.org/spring/she/pdfs/safelec/SAFELEC_8th.pdf)

for rail demonstrates the need for economic regulation to make a detailed assessment of safety costs and to avoid any perception that cost-cutting has led to a reduction in safety standards.

**19.** The electricity industry does not share the 'safety case model', so Ofgem cannot draw on the detailed safety data with which it is provided by HSE in respect of gas. This heightens Ofgem's responsibility to engage HSE in the health and safety aspects of its Regulatory Impact Assessments of its policies (including DPCRs) and to encourage DNO behaviours that address appropriate health and safety priorities.

**20.** Given the growth in distributed generation and the wish to encourage innovation in the industry, we would wish to see an improvement in safety regulation through the introduction of a charging regime. Whilst paragraphs 3.82 to 3.89 of document 94/09 state bluntly that the proposals do not affect the ability of DNOS to meet all their health and safety requirements, we believe that the baseline needs to reflect the challenges of the shift from passive to active networks and the pressing need to improve performance as the electricity sector is one of the few areas of the British economy to experience a declining safety record.

**21.** Given Ofgem's firm view, Prospect would like to see Regulatory Impact Assessment transparency, particularly in relation to the health and safety impact on workers and the public. We wish to be assured that Ofgem has addressed the foreseeable conflict that can arise from incentives that encourage the DNOs to meet certain behaviours that benefit consumers: for instance, the pressures on DNOs to maintain supply requirements that encourage 'live' work; and the incentives constantly to increase work tempo that can pressurise workers and produce the conditions for unsafe acts to occur and accidents to be concealed. As a prudent regulator, we would expect to see evidence that Ofgem has considered the impact of incentives and ensure that incentive schemes reward proactive health and safety management where appropriate and encourage adoption of HSE's strategy to be "a part of the solution" through strong leadership and worker involvement. We believe that the incentives offered for improving performance on customer interruptions and customer minutes lost should fully reflect the need to improve safety to match more efficient methods of operation. At this stage we are not convinced that the incentive scheme fully reflects these costs.

**22.** The absence of rationale or explanation for the inclusion of employee safety amongst the list of desirable behaviours at paragraph 2.30 implies that this process has yet to be completed and that Ofgem has yet to highlight the salient health and safety behaviours it would like to encourage. We trust it is not a reflection of Ofgem lacking the necessary expertise or necessary support from the HSE. Prospect has previously sought reassurance that Ofgem is suitably equipped to deal with health and safety considerations. We therefore welcomed the appointment by Ofgem of a head of profession for engineering in March.

**23.** Additional areas of health and safety risk in which Prospect believes Ofgem should take an active interest are asset theft and vandalism, both of which are increasing. These crimes may leave DNO assets in dangerous conditions as well as impacting on electricity supply (eg the Dartford cable bridge fire in July affected 100,000 customers). Our concerns are for the health and well-being of DNO customers and for the lives of workers carrying out the repairs. We believe

that the baseline revenue proposals for DNOs should reflect the need to improve security to avoid injury to employees and members the public as well as ensuring security of supply.

**24.** Energy supply is an industry increasingly reliant on contractors. Consequently, Prospect believes it is vital that *contractor* health and safety is given equal status to that of *employees* and that the financial incentives should ensure that equal focus is given to contractor safety as direct staff safety. This would align with section 15 of the Utilities Act 2000, which requires Ofgem to consult HSE where its decisions may have implications for the safety of “persons employed in connection with work activities”. Contractors should attract equal consideration in health and safety decisions as direct employees.

## **LABOUR COSTS AND SKILLS**

**25.** Prospect welcomes the fact that Ofgem has recognised that DPCR5 must make sufficient allowance for the DNOs to rebuild and renew their workforces in anticipation of the delivery of the significant network investment required to meet the challenge of a low carbon energy future.

**26.** However, we see contradictions in the manner in which Ofgem addresses the labour force issues in this latest consultation document. Ofgem states “we do not agree with the DNOs that the prices they pay for materials and labour will rise significantly in excess of inflation over the 2010-2015 period. We are currently in the most severe global recession in over 70 years... we therefore expect DNOs to be able to negotiate to keep their costs at or below inflation”.

In our opinion the expectation that labour costs in particular can be maintained at or below inflation over the next 5-year period is simply unrealistic. This view arises not from what may be the conventional expectation that a trade union would seek to raise labour costs to further the interests of their members, but rather because it is contrary to the evidence of the growing recruitment and retention challenge across crucial occupational groups in the sector. It is also in contrast to the fact that Ofgem recognises that a significant period of workforce renewal needs to be provided for in the revenue allowances for this price control period. Moreover given the need to redesign the operation of networks to address environmental issues, the revenue baseline should reflect the fact that an increase in the level of skills required across electricity networks will see an increase in average salary costs that far exceeds the salary increases paid to individual members of staff.

**27.** Whilst there is clearly evidence of subdued bargaining activity in the face of recession induced pressures in many parts of the economy, that picture is not reflected in areas where highly skilled occupations are engaged: such as the electricity supply industry and the distribution businesses in particular. Prospect represents the managerial, engineering and specialist staff in energy supply and the evidence from our negotiations with employers across the sector is that there are self-evident skill shortages. This means that reducing labour costs for these groups is unrealistic and in fact considerable pressures are arising from the chase for scarce talent.

**28.** The assumptions set out in paragraph 4.103 of document 94/04 run contrary to our experience of the sector and if they determine the approach to skills

issues, then efficiency and customer service shall suffer. We would welcome the opportunity to discuss these points directly with Ofgem.

**29.** Turning to the more specific aspects of the skills agenda, we have worked closely with Energy and Utility Skills (EUS) and more recently the embryonic National Skills Academy for Power (NSAP). We support the analyses that have emerged and which have informed the Ofgem proposals for DPCR5 and welcome the commitment to work with EUS. We are not at all surprised by the DNO conclusions that are described in consultation document 94/09 in paragraphs 2.34 and subsequently in relation to the contribution of indirect costs to rising forecasts from the DNOs in relation to network operating costs. In particular, the rise in estimated costs associated with engineering indirects is in our opinion simply a reflection of the need to replenish the skills that have been lost over previous price control periods. The previous sharply dipping trajectory on technical staff numbers has resulted from the cost control pressures that Ofgem has sought to exert upon the DNOs.

**30.** Moreover, there is the need to furnish new skills in order to meet the greater technical challenges arising from the connection of new forms of distributed generation, which imply more active management of the distribution network and to facilitate the achievement of the low carbon targets set in overall Government policy.

**31.** The increase in DNO forecasts for costs in respect of workforce renewal, which are captured in paragraphs 2.43 and in the subsequent tabulations, are again of no surprise to Prospect when one considers the change in the shape of the industry over the last 15 years. It is essential that Ofgem recognise that the process of workforce renewal needs to be smooth and sustained over more than one price control period. The EUS modelling and forward projections in respect of not only DNOs but also transmission and generation workforce renewal illustrate a daunting challenge in finding the necessary staff and skills, without which Government policy will simply be undeliverable. It is worth underlining the point that just as the DNOs seek to replenish their workforces, there are parallel strands of energy policy soaking up skilled labour in respect of nuclear decommissioning, nuclear new build, carbon capture and storage and of course the whole renewables sector.

**32.** We welcome the proposal that the DNOs will need clearly to account for how they are spending the money allocated by Ofgem in this and other respects. This will certainly address earlier concerns of the trade unions and indeed perhaps Ofgem that allowances in previous price periods have not been adequately spent. However, if there is any lingering suspicion that in this price period DNOs may be seeking allowances for workforce renewal that have effectively been previously available, that of itself must not deflect Ofgem from the stark reality that these workplace issues are real. Ofgem should focus upon ensuring the DNOs deliver their forecasts rather than spending a disproportionate time whittling away these forecasts because of concerns about the posture adopted by the DNOs in earlier price reviews.

**33.** Prospect believes that skills are potentially a major constraint on changes that improve the effectiveness and the environmental impact of electricity distribution. We have therefore worked with major employers and other stakeholders in the sector to address skills issues, both at company level and

through EUS and NSAP. We believe there is a consensus between DNOs, generators, National Grid and major contractors that skills must be addressed now and that a long-term approach is required. Therefore we would wish to see *skills* considered as a valid trigger for innovation payments under schemes such as the Low Carbon Networks Fund.

**34.** Given the long-term nature of skills development, such as 4/5 years training for a professional engineer, we believe that Ofgem needs to take a long-term view. We expect long-term skills issues to be addressed in the RPI-X@20 process but we are concerned that the split between opex and network investment set out in this paper is weighted too heavily in favour of capital investment. We would wish Ofgem to reconsider this weighting to ensure parity of reward for opex and capex spending on skills so there is no incentive to distort skills investment.

## **SECTION 2 - BEHAVIOURS, INCENTIVES, FUNDS AND OBLIGATIONS**

**35.** Given the significant challenges posed by the transition to a low-carbon economy, we welcome the commitment from Ofgem to encourage the environmental behaviours set out in paragraph 2.5. We are particularly pleased by the recognition that DNOs need to act now if we are to adjust to the profound changes in network use anticipated after 2015. However we are not convinced that the mechanisms proposed are adequate to meet this challenge, especially in the area of skills given the need to develop a wider range of professional skills across the sector.

**36.** Whilst we welcome the establishment of the Fund, we are concerned about the lack of clarity over the Low Carbon Networks Fund and the implication that Low Carbon trials can be conducted independently from the operation of the remainder of the network. The requirement for sharing output from such trials takes an unduly positive view of the commercial benefits of sharing innovation without recognising that incentive regulation and incentives create a financial driver for independent evolution of network operations. In particular, we are concerned about the proposals in 2.19 to constrain innovation in DPCR6 by preventing funding of trials that replicate the lessons learnt by other DNOs through the Low Carbon Networks Fund and to allow independent operators to conduct trials on DNOs. Independent trials raise serious safety concerns in a highly hazardous industrial environment and also introduce a significant element of risk in investment that could increase the cost of capital to the detriment of consumers.

**37.** Whilst Prospect recognises the value of a more sophisticated measure of consumer service, we are concerned that the range of measures outlined in 2.23 actually present clear incentives to DNOs to improve service. We welcome the introduction of margins in connections subject to minimum standards (2.225/26) but believe that the reward for this service should be comparable to core network operations since we believe that the involvement of DNOs in connections work is likely to remain key to the provision of a full range of connections services up to 2105.

**38.** In principle, we support the move to incentives linked to defined outputs that benefit consumers. So long as the financial rewards for improvements are realistic to meet the medium-term cost of introducing change, including skills development of staff, and the various incentives are limited in number and not

contradictory. With the exception of an incentive linked to safety, in principle the incentives set out in paragraph 2.23 are reasonable measures.

**39.** With regard to network behaviours, we recognise that the six principles set out in 2.30 are reasonable. We especially welcome the workforce renewal incentive. Given our past concerns about the distortion of financial incentives by the perception that Ofgem prefers network investment to operational expenditure, we support the aim of removing the incentive to play expenditure between opex and capex set out in 2.31.

**40.** Given our concerns about network resilience, we welcome the commitment to produce a more sophisticated set of measures as set out in paragraph 2.41 and the commitment to retain the Innovation Funding Incentive (IFI) as explained in paragraph 2.35.

### **Section 2: Question 1**

**41.** Given the need to retain a comprehensible set of incentives, there is a limit to the number of measures so we would only advocate the addition of an incentive linked to safety. However we fear that some of the measures remain imprecise and believe that incentives should reward skills development, given sector change requires the development and use of a wider range of professional skills.

### **Section 2: Question 2**

**42.** The incentives provide a greater reward for desirable behaviours, which is positive. However we wish to see a swifter introduction of a robust network health index.

### **Section 2: Question 3**

**43.** It is difficult for Prospect to determine whether the incentives are likely to be successful so we believe that so testing of incentives would be appropriate to determine their effectiveness. For incentives to provide a clearer signal we advocate a focus on unambiguous outcomes, the inclusion of staff training and development in incentive schemes and the avoidance of perverse outcomes (such as a deterioration in health and safety).

## **SECTION3 - PROPOSED ALLOWED REVENUES**

### **Section 3: Question 1**

**44.** Given the pressures to improve performance, replace aged assets and respond to the challenges of increased distributed generation, the proposed increases seem inadequate to fund investment and innovation. We believe that the expected replacement rates of 5% to 10% for equipment when there is a peak of equipment installed in the 1950s and 1960s is unduly modest - even if we did not expect significant changes and investment as part of the process of moving from a passively controlled network to a system with greater use of Distributed Generation, increased consumer interaction to address demand peaks and wider innovation. In these circumstances, we believe that the 17% cut in network investment from company proposals is too great. In addition we believe

that the proposals' approach to safety spending is unrealistic given the significant safety challenges that result from innovation and distributed generation.

### **Section 3: Question 2**

**45.** Given the significant changes in the industry predicted over 2010/15 and the existing skill shortages, we believe that the assumptions for modest salary increases is simply untenable and that the revenue allowances should recognise the need to recruit and retain professional staff.

### **Section 3: Question 3**

**46.** Given the uncertainty generated by change to meet the challenges of climate change, growing consumer expectations and the need to improve asset resilience, Prospect believes that PriceWaterhouseCoopers' estimate of Weighted Average Cost of Capital (WACC) is over-optimistic. We have two associated concerns about the cost of capital: (i) the impact of uncertain revenues due to incentive schemes and (ii) the uncertainty about pensions recovery. Uncertainty about revenue tends to increase the cost of capital and we remain concerned that a lack of clarity about the precise nature of incentive schemes could increase the cost of capital.

**47.** Given the significant cost of addressing pension costs, we are concerned about the impact on WACC of uncertainty about the long-term resilience of the arrangements to repair deficits in defined-benefits pension schemes. We have responded separately to the Ofgem pension principles consultation<sup>4</sup>. We are concerned that continued review of the current arrangements disadvantages consumers by increasing perceptions of regulatory risk as investors fear that Ofgem is reserving the right to unwind the arrangements for deficit repair at short notice. We believe that the exposure of DNOs to a proportion of deficit costs that cannot be recovered exerts significant commercial pressure efficiently to manage pensions schemes. So moves to deter companies from using such schemes are unnecessary and distort judgment.

### **Section 3: Question 4**

**48.** We believe that it would be more prudent to maintain existing WACC returns rather than reduce allowed returns and establish a scheme to cover debt uncertainty. In the same spirit, it would be useful to establish defined criteria to trigger a reopening of the price review if interest rates rose substantially or other market factors led to a significant increase in WACC costs such as a requirement to increase the level of debt covered by equity.

### **Section 3: Question 5**

**49.** We believe that the details of a debt trigger mechanism are best informed by a detailed understanding of company debt structures: Prospect's access to this information is insufficient for us to comment.

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<sup>4</sup> Submission by Prospect on Ofgem's 2nd consultation on its pension principles for price control reviews, sent 11 September 2009.

## **SECTION 4 - RISKS AND REWARDS**

### **Section 4: Question 1**

**50.** So long as the established WACC reflects the uncertainty facing DNOs and the potential penalty for under-delivery is limited, then the process of calibration is reasonable. However, we believe that the need for innovation and change to meet consumer aspirations (for performance improvement and environmental impact) requires a more creative approach to management than in the past with an increased risk that innovation does not improve performance. In these circumstances, incentives should be geared to promote change. Moreover we are unconvinced that over-performance in current incentive schemes is a sign of the schemes being too lax: our experience of the significant changes made to respond to incentive schemes suggests that the schemes have been very successful in persuading DNOs and their professional staff to respond efficiently to consumer needs.

### **Section 4: Question 2**

**51.** Given the significant investment requirements to maintain and improve network performance, it would be more prudent to encourage investment by allowing a higher WACC that undermines investment.

### **Section 4: Question 3**

**52.** We would wish to consider the more detailed proposals for calibrating incentive schemes. However we believe that the scope for further variation in prices to reflect performance is limited due to consumer resistance to price rises.

### **Section 4: Question 4**

**53.** Given the pressure on consumers and DNOs to encourage energy efficiency, we welcome the decision to remove unit distributed and consumer numbers as drivers for cost.

## **CONCLUSION**

**54.** Prospect welcomed the opportunity to comment on the proposals. We would welcome a future opportunity directly to discuss in detail with Ofgem the issues we have raised.

**Prospect  
September 2009**