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Dear Rachel

September and October Updates to Initial Proposals

I attach our responses to your September and October updates to the Initial Proposals.

Ofgem's revised proposals continue to fall short of meeting our requirements. They will inappropriately increase risks and long term costs for the customers of the North West. We have a lot of work ahead of us before we can conclude this price control debate, the key elements of which I set out below.

Firstly, I am gravely concerned that a number of your modelling approaches significantly disadvantage ENW without any sound basis. Several aspects of your modelling approach are deeply flawed. In other areas a lack of transparency prevents us from understanding why our proposals have been rejected. In particular:

- We note that Ofgem's unjustified selection of overall benchmarks for network operating costs and indirects is deliberately adjusted, leading to a result that favours other DNOs and reduces ENW's allowances by £11 m
- We have demonstrated that making seven logical changes alone to your comparative efficiency models would improve robustness and validity, improve results of statistical tests and increase ENW's allowances by £19m.
- Cherry-picking across capex unit costs by applying a "lowest of" approach reduces ENW's allowances by £43m

Ofgem's approach falls some way short of meeting the recommended Competition Commission best practice in respect of the three general principles applied to economic modelling, namely: Clarity and Transparency; Completeness; and Replication of Results.

Secondly, I am also concerned that your proposals introduce significant increases to risks faced by DNOs, for example via the introduction of riskier incentive mechanisms, by failing to fund efficient proposals and by failing to provide RPE allowances to

recognise the fact that capex costs are projected to increase above inflation over the DPCR5 period. I am frustrated that the mechanisms proposed in your September update to mitigate risks are in some cases likely to introduce further risks for DNOs. For example mechanisms that propose only funding 95% of efficient future costs actually increase the risks associated with uncertain future obligations. We have proposed a number of mechanisms by which Ofgem could reduce the risks faced by DNOs in DPCR5 towards the level of risks perceived at the same stage in DPCR4 negotiations.

Finally, I note that you have acknowledged that a number of material errors exist in the analysis that you published in your October update and am pleased that you have agreed to correct for these. The materiality of these issues is generally greater for ENW than for other DNOs. I am concerned, however, that further errors may be introduced in the final stages of your analysis that may manifest within your Final Proposals.

My team and I will continue to work with your team to minimise the risk of further errors being introduced, to identify a sensible set of costs allowances that recognise the efficiency and validity of ENW's forecasts and to specify a coherent regulatory framework that avoids customers facing significant cost increases for increased DNO risk. However, our time on this project is rapidly running out. I note that your team are actively considering a delay to the Final Proposals. Whilst this is obviously very inconvenient for all concerned, I believe that if a few extra weeks' work can avoid the delays, expense and distraction of a Competition Commission reference then it will be time well spent.

Yours sincerely,

Paul Bircham
Regulation Director
Electricity North West Limited