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Dear Rachel,

**Electricity Distribution Price Control Review – Review of process**

1. We welcome the opportunity provided by this consultation to comment on the process Ofgem followed for DPCR5. We spend around £800million per year on electricity distribution charges, and these account for around 20% of a customer's electricity bill. Therefore, the level of revenue deemed necessary to finance network operations, and the way these costs are charged to suppliers have a major impact on our business.
2. As Ofgem is aware, we are unique amongst the major energy suppliers in participating actively in the price control reviews as a supplier, whilst not owning any energy networks. This gives us a particularly important perspective on the price control review and the outcomes that are in the best interests of customers.
3. There have been many positive aspects to the process followed by Ofgem in DPCR5, and the process has continued to build on the positive aspects of GDPCR. We welcome the consultation that has taken place during the review, and the invitation to present our views to the Authority at key points in the review.
4. Nevertheless, we still have some concerns about important aspects of the process. In particular, there were material changes between the initial and final proposals, almost all of which benefited the DNOs, on which we and other stakeholders had no effective opportunity to comment. If we had a clear process by which we could appeal final proposals, then the exclusion of supplier and consumer input from the final stages of the review might be more understandable. However, while we continue not to have an effective right of appeal, the price control process remains imperfect.
5. In the remainder of the response we have set out our comments under four broad themes:
  - what worked well;
  - the effectiveness of the DNOs in engaging with stakeholders;
  - potential areas for improvement; and
  - ideas for improving the process in the future.

## What worked well?

6. The introduction of the RORE measure and an increasing focus on output regulation and other measures of wider stakeholder satisfaction with DNOs has been important in providing clearer accountability for the DNOs (and Ofgem) regarding the outcomes of price controls. Moving forward it will be important to build on this, for example, by Ofgem publishing RORE analysis for each DNO for each year of the price control so we and other stakeholders can see their performance and understand how well the price control is working. Revealing this information during this price control will help to build transparency and understanding amongst all stakeholders.
7. We welcome the consultation that characterised the price control review. The new hierarchy of consultation documents (with higher level documents summarising the key points, alongside more detailed supplementary documents) worked well. We would encourage Ofgem to continue to follow this approach in future price control reviews.
8. We also welcome the increased focus on consumer interests in the review, and this is consistent with the emerging thinking from the RPI-X@20 review. The role of the Consumer Challenge Group can be important in this context, but it would be helpful to understand more about the role of this group if Ofgem intends to adopt this approach in the future.<sup>1</sup> It may be particularly valuable for this group to focus on areas of price control reviews that affect consumers, and for which other external stakeholders do not focus resources (rather than duplicating the work of ourselves and other stakeholders).

## DNO engagement with stakeholders

9. There have been a number of improvements in the interaction between DNOs and stakeholders (including ourselves) during DPCR5. However, this starts from a very low base. Some DNOs, for example, still do not accept that British Gas and other suppliers should be treated as customers of the networks. While others are much more progressive in their thinking, this demonstrates how far the networks as a whole have to go in becoming customer-focused organisations.
10. This also applies to important parts of the price control process. On occasion, we were not invited to relevant and appropriate meetings or had to specifically ask for invitations (for example on early meetings on cost of capital hosted by the ENA with Ofgem). We do, however, appreciate the occasions on which the ENA has hosted meetings and invited us to join for certain agenda items. While DPCR5 took some important steps forward, price controls are still fundamentally structured around a bilateral process of negotiation between Ofgem and the networks. If customers are to become truly engaged in future controls, this must be addressed.
11. The way in which customers are engaged also needs to recognise the breadth of interests that have to be captured in the process. Some customers only want to be engaged in price control issues at a relatively high level. Other customers, such as British Gas, want to engage in a far more detailed level (reflecting the commercial impact price control decisions have on our business, and the fact that we spend around £800million of our customers' money every year on electricity distribution costs).
12. As Ofgem is aware, we found it particularly difficult to obtain good quality information from DNOs about the implications of price control proposals for our charges. This is best exemplified by our discovery (after the October update document had been published) that the 2009/10 charge baseline provided by DNOs to Ofgem was based on outdated assumptions on volume drivers. This meant that the year-on-year increase in charges implied by the proposals was larger than stakeholders would have understood simply by reading Ofgem's price control documents (from an increase of 14% to an increase of 21%). This illustrates that the DNOs have a long way to go in presenting critical information in a format that is helpful to their customers, despite Ofgem's best efforts in this area.

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<sup>1</sup> We understand that Ofgem is proposing a similar group for the adapted rollover of the transmission price controls.

13. It is crucial that Ofgem is clearer about the minimum requirements it expects DNOs to meet with regard to stakeholder consultation and the provision of information to stakeholders. While we welcome initiatives that improve the responsiveness of DNOs to their stakeholders, we recognise that there will always be limitations to the ability of stakeholders at the distribution level (in contrast to transmission) to engage effectively with DNOs. In our view this increases the importance of third parties, such as ourselves, having a right of appeal consistent with the consultation for the RPI-X@20 review. We will set out our views in more detail on this issue in our response to the emerging thinking consultation.

#### **Potential areas for improvement**

14. Aside from the introduction of third party rights of appeal on the final proposals, a further concern is that detailed mechanisms of some very important initiatives such as the LCNF are sometimes not developed until very late in the price control review (or after the review has been substantially completed). Where this means material aspects of the mechanism are being decided late in the process, we are concerned this may increase risk for customers. A good example of this is the DPCR4 losses incentive, which was developed at a late stage in the previous price control process with minimal engagement by stakeholders. The resulting incentive was poorly specified, and delivered large windfall gains to networks with little reduction in measured losses (and increases in measured losses in some instances).
15. While we recognise that Ofgem receives a lot of material in response to its consultations, it is often hard from Ofgem's documents to see how comments from third parties other than DNOs have been taken into account. The cost of capital issue is a good example of how third parties' views were discussed and considered in the documents. However, for other issues it is often less clear how views were taken into account. For example, we provided detailed input on the issue of menu regulation early in the price control review, however the decision to retain the basic structure of the IQI (while changing the costs to be covered) was adopted with little discussion of alternative views. As a minimum it would be helpful if Ofgem included an annex with all its documents that summarised respondents' views, explaining how these were taken into account.
16. We recognise that much of the analysis on operating and capital expenditure requirements is technical, and difficult to easily present or explain in consultations. However, there were a number of decisions regarding allowed expenditure that were not intuitive given our knowledge of the market and which were poorly explained by DNOs. The best example of this was the level of reinforcement expenditure allowed in the control during a period of low demand growth. We would suggest that in future controls, Ofgem should consider leading either specific workshops on these more technical issues or requiring the DNOs to develop an accessible explanation and justification for its business plan proposals, one that can be digested and understood by the wider community of stakeholders.


#### **Improving the process**

17. We are separately responding to the consultation on the Emerging Thinking for the RPI-X@20 review. We believe there is much to welcome in the emerging thinking that could improve the process for future price control reviews.
18. We will set out the reasons why we believe third party rights of appeal are appropriate in more detail in our response to the RPI-X@20 review. Our response will also set out how we believe the mechanism should be designed to ensure a balance between appropriate rights of appeal and avoiding frivolous and unmerited appeals. Importantly, we agree with Ofgem that the current regulatory framework already allows third parties to ask Ofgem to refer price control settlements to the Competition Commission on consumer interest grounds. We therefore ask Ofgem to provide clear guidance on how such requests should be structured, and the process by which such requests would be assessed and actioned.
19. Regular evaluation of the effectiveness of the price control and the performance of the regulated companies is crucial to providing effective accountability. It is therefore important for Ofgem to publish an annual assessment of the RORE achieved by each DNO, alongside information on cost outturns, incentive revenue and other output measures on an ongoing basis. We would also

encourage Ofgem to use this information as a starting point for a review of the effectiveness of the price control at the start of the next review, to ensure that lessons are learnt about which aspects of the price control have worked well and where there are areas for improvement.

20. Overall we consider there is much to welcome in the DPCR5 process, and we believe the emerging thinking for the RPI-X@20 review could, if fully implemented, (including third party rights of appeal) go a long way to addressing many of our remaining concerns.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'Philip Davies', with a long horizontal line extending to the right.

Philip Davies  
Director of Regulatory Affairs  
British Gas