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Dear Hannah

Open letter consultation on the way forward for the next electricity distribution price control review – RIIO-ED1

Thank you for the opportunity to meet with you yesterday and gain your insights to the ways we must work together to tackle the key challenges facing the industry in RIIO-ED1. I am pleased to respond to your open letter which marks the formal start of the RIIO-ED1 price control review. We have been discussing our customers' and stakeholders' requirements for RIIO-ED1 for some time and will continue to do so while we formalise our plans. We recognise that our business plan will benefit from the proactive input from our wide range of stakeholders and we are actively engaged with all of our customers to help us to build a plan which will serve the North West over the next decades.

We welcome Ofgem's recognition of the essential role of DNOs in enabling the efficient migration to a low carbon future and the central role this will play in the formation of investment plans for ED1. RIIO-ED1 covers a period of significant change for distribution networks. We all expect significant changes to customers' requirements of the distribution networks over the next price control as we seek to deliver a sustainable energy sector which supports a low carbon economy. We recognise the difficulty in predicting the timing and location of required investment as low carbon technologies are rolled out. This uncertainty, combined with the longer price control period and uncertain economic conditions will have to be reflected in our business plan.

It is important that Ofgem recognises the significant changes for the network companies in RIIO-ED1. Many of the positive aspects in DPCR5 were included as part of the RIIO price controls (many of which should be carried forward into ED1) but the proposed changes in the future financeability policies will provide significant challenges for the networks. Ofgem must ensure that the transition to the RIIO financeability principles does not jeopardise the delivery of low carbon policy objectives. We are pleased to note that Ofgem recognises the importance of financeability and that its letter leaves open the option for Ofgem to use the most appropriate tool for resolving any financeability issues created by the implementation of the RIIO policy framework.

We will build on our innovation strategy to develop appropriate investment for our region to ensure delivery of network health, delivery of low carbon sustainable energy and delivery for our customers at appropriate price. It is important that companies are appropriately rewarded for adopting a more innovative approach to managing the network.

Key objectives of RIIO-ED1

We agree that ensuring the timely and cost effective connection of low carbon technologies should be a key objective for RIIO-ED1. DNOs can make a significant contribution to the achievement of Government targets for carbon reduction. The price control must incentivise DNOs to have in place sufficient network understanding, network capacity, connections resources, business flexibility and efficient processes to facilitate the delivery of low carbon connections.

It is also important that we recognise the uncertainty that arises as a consequence of moving to a low carbon economy. The transition to a low carbon economy must be planned against the objectives and timetable described in the 4th Carbon budget. Whilst uncertainty exists, investments need to be set against this agreed baseline for Distributed Generation and demand growth, particularly in the period up to 2031. The network companies and Ofgem must work together to develop strategies and mechanisms that appropriately allocate risk but also incentivise DNOs to bring forward innovative techniques and efficiencies. We are committed to working with you, other DNOs and interested stakeholders this year to develop a regulatory framework that can achieve these aims.

The bulk of the investment programme for RIIO-ED1 will be focused on asset replacement as assets installed in the 1950s and 1960s come to the end of their operational life. This represents a significant opportunity to ensure that the most appropriate assets are in place for future network requirements. It is important that when Ofgem is attempting to compare costs across networks, your models recognise the long term benefits of investment, innovative solutions to resolve issues or the efficiency of avoided investment. We will work with Ofgem to develop tools and mechanisms which recognise the changing balance of investment and performance drivers in ED1.

Investment plans will encompass many intervention drivers including safety, asset condition and risk, compliance with legislative requirements and changes in loading. The overall investment plan should make use of efficient intervention options, for example potentially upsizing non-load related investments where future load projections indicate a high probability of reinforcement being needed by 2031. So called 'anticipatory' investments will need careful justification and stakeholder support, but potentially offer an efficient whole life cost and delivery mechanism when compared to single driver intervention approaches.

Rolling forward DPCR5 methodology into RIIO-ED1

A number of the mechanisms that are in place in DPCR5 should be rolled forward into RIIO-ED1. We suggest that safety work programmes, Interruptions Incentive Scheme (IIS), funded innovation programmes (including Network Innovation Competition), undergrounding, workforce renewal, tax allowance setting, tax clawback and pensions principles are equally relevant to a successful ED1. These mechanisms represent value for money for customers and produce efficient and effective outcomes.

Cost assessment in RIIO-ED1

We have already highlighted the importance of developing the most appropriate models to compare companies' costs. The models must measure the efficiency of outcomes rather than the number of units added to the network, must recognise the trade-offs between activities to avoid inappropriate assessments (cherry picking) in setting allowances, and must recognise the impact of fixed costs in the analysis. Ofgem must satisfy itself that its modeling produces robust results. The first step in achieving this is to ensure that all costs and data are reported on a consistent basis.

Serving local communities

We recognise that DNOs have an important role in local communities. Our proactive stakeholder engagement activities already include working with local authorities and other regional stakeholders, this will continue throughout the price control. Local authorities provide a key input to our network expansion planning. We will be discussing the local authorities' requirements over the RIIO-ED1 investment period to identify where we can do more work together. We suggest that a proactive review of the act and licence should take place to ensure that the existing legislation does not become a barrier to DNO involvement in community schemes.

Length of RIIO-ED1 price control

We do not have a strong view on the most appropriate duration for RIIO-ED1, as long as the increase in risk is appropriately compensated in the regulatory package. We have already indicated our view that the risk profile for RIIO-ED1 is inherently greater than that for previous price controls, primarily as a result of uncertainty in the investment requirements for a low carbon future. Moving to an eight year plan (the default price control length under RIIO) from the traditional five year investment plan compounds this level of risk and uncertainty for DNOs. Extending the price control duration further will have additional implications for the level of risk. From a practical perspective, if the price control was extended by 1 year, the ED1 mid-point review would take place at the same time as the GD2 and T2 negotiations which is likely to create additional resource issues for Ofgem.

Lessons from RIIO-T1 and GD1

As part of our preparation for the RIIO-ED1 price control, we have reviewed the RIIO-T1 and RIIO-GD1 price controls to understand the implications of the new regulatory framework for our customers, stakeholders and investors. We will use this learning to ensure that customers can gain access to clear, concise and appropriate information on our plans for the region. We have some concerns with the approach adopted by Ofgem when reviewing gas and transmission business plans. We encourage Ofgem to assess the full package of proposals rather than "marking" individual components of the plan against the strategy paper and well justified business plan criteria. We support Ofgem's conclusions that there should be greater comparability of the headline plans for ED1. In particular, Ofgem should adopt comparable output measures to fully achieve meaningful comparisons. It is also essential that Ofgem provides companies with clear well justified business plan criteria.

Company stakeholder engagement

We fully support customer and stakeholder engagement as a central component of the RIIO-ED1 price control. We have been active in customer and stakeholder engagement for many years and we recognise and understand the importance of placing customers and stakeholders at the heart of our decisions. As part of our RIIO-ED1 stakeholder engagement programme, we have launched our "Switched On" microsite (www.electricitynorthwest.co.uk/switchedon) to allow customers and stakeholders to contribute to the plan, understand our proposals and how their feedback has been incorporated into the plan; this is supported by a series of proactive customer focussed events to encourage direct feedback. We have also launched our own stakeholder forum, which will play a key role in our ongoing stakeholder engagement and in formulating our well justified business plan.

Stakeholder engagement groups

We do not propose any changes to Ofgem's central existing stakeholder engagement approach. We recognise and acknowledge that different customer and stakeholder groups will have different priorities for RIIO-ED1 and these views will sometimes be contradictory. Where contradictions are seen it will be necessary for companies, Ofgem (through their strategy paper) and sometimes DECC to make decisions about the relative priorities.

We welcome the formation of the overarching flexibility and capacity working group. We believe that such a group is essential to maintain focus on the desired outcomes for our customers and stakeholders and so structure any future outputs and incentives regime as to ensure those outcomes are attained.

If you have any questions, please feel free to contact me or any of my team.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'PB', is positioned above the printed name and title.

Paul Bircham
Customer Strategy and Regulation Director

cc Anna Rossington
Andy Burgess
Chris Watts
Dora Guzeleva