

OPEN LETTER CONSULTATION ON THE WAY FORWARD FOR THE NEXT  
ELECTRICITY DISTRIBUTION PRICE CONTROL REVIEW - RIIO-ED1

THE RESPONSE FROM NORTHERN POWERGRID

23 March 2012

## EXECUTIVE SUMMARY

1. Ofgem's move to the revenue and incentives set to deliver innovation and outputs (RIIO) framework is intended to provide greater focus on outputs and give stakeholders greater influence. At the same time, it is intended to enable energy networks to play a key role in the decarbonisation of the economy, while ensuring efficiency against a backdrop of rising costs.
2. This gives rise to both a set of strategic imperatives for the review, and a series of actions that could help to create the time and space required to meet the challenges posed by the changing electricity sector.

### *Strategic imperatives for the review*

3. Bearing the purpose of RIIO in mind, Northern Powergrid agrees with Ofgem that the key focus of the review should be on ensuring that arrangements are in place to support distribution network operators (DNOs) in providing a network that has the required capacity and flexibility.
4. At the same time, the review should bear in mind the need to ensure that investment is undertaken at the lowest possible cost, and that the prospects of it becoming redundant are not too great. The review needs to start with a clear set of objectives. To meet these, a balanced set of incentives should be designed, calibrated and implemented. Given the changes in the sector that the RIIO framework is designed to address, this should be done in a way that does not constrain how companies pursue profit through innovation, and does not lead to micro-management.
5. Investment is also likely to remain at the elevated levels seen in the fifth distribution price control review (DPCR5) period, or to increase further, depending on the speed and level of uptake of low-carbon technologies. While the settlement must allow enough flexibility for companies to respond to this, it is also imperative that it can attract the funds required to finance this investment.
6. Finally, the mid-period review offers a route to help deal with certain aspects of the current uncertainty. However, its scope must be carefully defined during the

course of the RIIO-ED1 review itself in order to preserve the benefits of a longer price control review period (regardless of whether the RIIO-ED1 period lasts eight or nine years).

*Creating the necessary time and space to meet these challenges*

7. To ensure that all parties to the review can dedicate appropriate time and resource to achieving these objectives, Northern Powergrid would support Ofgem in making some aspects of the review as light touch as possible. While this cannot be applied across the board, any issues where existing mechanisms are fit for purpose should be identified as soon as possible and locked down with the minimum of effort.
8. Other output areas may require more work to develop new metrics. However, in some of these cases there may be pre-existing metrics that are relatively straightforward to agree and implement, such as the safety reporting framework overseen by the Health and Safety Executive, or technical models of losses on DNO networks. Identifying these quick wins in situations where new outputs are required would also help release time to devote to the big issues.

## FULL RESPONSE TO THE OPEN LETTER CONSULTATION

### *Low carbon technologies and smart grids (question 1: should this be the focus of RIIO-ED1)*

9. Northern Powergrid agrees with Ofgem that this is a key issue for the RIIO-ED1 review. Accommodating low-carbon technologies in a timely and cost effective way requires both a flexible network that can provide the capacity required, and customer service by DNOs targeted on what low-carbon technology customers require. The importance of this issue over the coming decade is highlighted by Ofgem's recent proposals for an environmental discretionary reward in the electricity transmission industry.<sup>1</sup>

### *Providing capacity in a cost effective way*

10. There are several inter-related issues that relate to providing capacity in a cost effective way. These include investing in smarter grids, ensuring connection charges are set appropriately, incentives for ensuring that low-carbon technologies can connect, and approaches to ensuring that customers do not have a strong incentive to wait for others nearby to fund a connection. Northern Powergrid's views on these issues are set out below.
11. Creating this capacity and flexibility may partly depend on deploying 'smarter' network technology that can allow the same network to provide greater capacity. At the same time, it will be important to ensure that only worthwhile investments are taken forwards to help avoid unnecessary expenditure that customers will eventually need to pay for. We therefore agree with Ofgem that the Smart Grids Forum workstreams should assist in developing common methodologies for evaluating long term investments in this smarter network technology.
12. We also expect this review to revisit the question of connection charging 'depth', i.e. whether a connecting customer should contribute towards reinforcement requirements associated with their connection. Northern Powergrid believes that there is value in maintaining a price signal to encourage the connection of low-

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<sup>1</sup> These proposals feature a scorecard where five of the six criteria for assessing the reward closely relate to facilitating the cost effective connection of low-carbon technologies.

carbon technologies at locations where network capacity already exists. But the present arrangements should be reviewed to test whether too much of this cost is being loaded onto the connecting customers, and there could be merit in allowing the amortisation of reinforcement (i.e. spreading the costs of the connection over time within network charges). While this would effectively re-introduce tariff support for one class of customers, it would help ensure that only efficient low-carbon technologies are connected to the network, and reduce the loading of network reinforcement costs onto customers in general.

13. There is then a separate question of whether these connection charging depth arrangements would remain fit for purpose under all potential scenarios. Once the mass take-up of low-carbon technologies becomes a reality, planning network investment to accommodate it everywhere on the network may become more efficient than through piecemeal interventions. In this scenario, which still appears to be some years off, the inclusion of a much greater proportion of connection costs in the investment that is remunerated through the general price control may become warranted. This could be done either through general investment allowances, once the scale of the programme is known, or through the development of outputs that can act as 'allowance drivers' which would allow funding to flex in line with the speed at which low-carbon technologies are deployed. Care would also need to be taken to balance these arrangements. For instance, if unit cost allowance drivers were developed, these would tend to create a strong incentive for lower than average cost work to be undertaken, but no real incentive for higher cost work to be undertaken, so care would need to be taken to balance this incentive with other arrangements. Establishing appropriate levels for an allowance driver is also likely to be challenging, so thinking should begin now even if any scheme is unlikely to be implemented before the mid-period review of RIIO-ED1 outputs.
14. One feature of the current regulatory arrangements which has some of the properties of the revenue drivers described above is the DPCR5 distributed generation (DG) incentive. This could in principle provide a source of funding to encourage DNOs to invest appropriately ahead of need on a commercial basis, given that future connections could trigger additional revenues. However, the

rules on cost apportionment restrict the circumstances under which the incentive can be triggered, and the details of this scheme should be reviewed to ensure it plays the role it should at RIIO-ED1 if it is to be retained.

15. The DG incentive scheme is also narrowly defined relative to the scope of low-carbon technologies, since it only applies to low-carbon generation connections, and not to low-carbon demand connections such as heat pumps or electric vehicles. The incentive would therefore need to be extended to sources of low-carbon demand, in order to give coverage of all the low-carbon technologies that can trigger reinforcement. This will be made more difficult by the fact that requirements for customers to inform DNOs of new demand loads are not clearly defined, and are not well understood. The voluntary scheme which is currently being deployed may be sufficient, but could still mean that the required information does not reach the right people in the future, and that formal requirements should be considered.
16. There is one other feature of the current connections arrangements that now needs a review in light of the development of competition in the connections market, and which could facilitate the connection of low-carbon generation. In particular, the Electricity (Connection Charges) Regulations 2002 provide for connection customers of a DNO (but not an independent connection provider (ICP)) to receive a refund if the assets they funded are shared by someone else who connects within five years, provided the second connection is undertaken by a DNO (i.e. not an ICP). Since an increasing proportion of connections is being undertaken by ICPs, the intention of these regulations to allow connecting customers to potentially recoup some of their costs at a later date is now easily undermined. This can only serve to discourage low-carbon technologies from connecting in areas where the connection costs are high, even if there is significant latent demand for a connection in that area.

*Providing the customer service that low-carbon technologies require*

17. On the customer service aspects of providing capacity and flexibility for low-carbon technologies, Northern Powergrid believes that many improvements in this area are within the control of individual DNOs. We are currently pursuing several

avenues of improvement, and believe that it is for each DNO to identify and implement the approaches that it thinks will be most effective. However, not all the potential improvements in customer service can be achieved by individual companies acting on their own.

18. One area where a review of regulatory arrangements would be worthwhile is how design and quotation costs are recovered from customers. At present, these costs must be loaded disproportionately onto those customers who do go ahead with a connection. There is also no price signal to discourage speculative applications which can slow the process for other customers.
19. Cross-industry collaboration could also help to improve customer experience when connecting low-carbon technologies. These customers often also expect DNOs to be able to scope a connection based on the make and model of the equipment they intend to install, but at present the customers typically need to supply its specification. Co-operation between DNOs and equipment manufacturers could solve this problem for customers by reducing the amount of information they must supply. Northern Powergrid is ready to lead the industry in developing a national database, which would avoid duplication of efforts. Co-operation of all parties involved would be required to deliver its potential benefits, so an early signal from Ofgem as to whether it expects equipment manufacturers and DNOs to collaborate in developing this would be helpful.

*Review of DPCR5 mechanisms (question 2: which outputs remain fit for purpose?)*

20. Northern Powergrid supports Ofgem's initiative to review the DPCR5 mechanisms in order to identify those where less development work is required as part of the price control review. This will release time both for Ofgem and other stakeholders (including DNOs) to devote to the more pressing issues that must be considered. Below we set out our reasoning, and our own initial evaluation of the DPCR5 mechanisms.
21. We agree with Ofgem's view that the DPCR5 approach to establishing outputs and allowed revenues involved many of the elements that have now been built into the

RIO framework. Some of these elements were new innovations during the course of the review, such as the network 'outputs', now termed secondary deliverables under RIO. Others were an evolution of mechanisms that had been implemented in earlier price control reviews, such as the interruptions incentive scheme (IIS) and associated reliability outputs.

22. Our own evaluation of the DPCR5 arrangements suggests that the following output and incentive elements of the DPCR5 settlement are already subject to adequate arrangements such that a lighter touch 'refresh' could be undertaken in order to make them appropriate for the RIO-ED1 period.

- **The interruptions incentive scheme (IIS)** - the IIS is now bedded in and its operation is well understood. Targets that are based on each DNO's network position regarding faults and customers per fault make sense, since many opportunities to improve network performance will already have been exploited, and the differences between DNOs may now reflect inherent differences between their networks. All that is needed is an appropriate methodology for setting targets, that does not prevent the opportunity for outperformance, coupled with an appropriate incentive strength. The one potential issue that could require modifications to the existing arrangements is the potential impact of the smart meter roll-out on restoration times and customer minutes lost, which we discuss further in the section on the smart meter roll-out below.
- **Customer service broader measure (CSBM)** - the DPCR5 CSBM has been a positive move, and it has significantly shifted focus onto customer service compared to previous arrangements. It is still being made operational as part of DPCR5, however, and we would therefore expect the RIO-ED1 review to concentrate on ensuring that teething problems are ironed out in time for the price control to start, rather than fundamentally changing the output and incentive architecture.
- **Arrangements for funding innovation** - the DPCR5 low carbon networks (LCN) fund arrangements have been effective in creating a step change in the level of work undertaken to develop innovations that will help facilitate low-carbon technologies, as has the wider set of DPCR5 period incentives. It

is appropriate to continue these arrangements as part of the network innovation allowance (NIA) and network innovation competition (NIC) proposed under the RIIO framework.

- **Workforce renewal arrangements** - the DPCR5 arrangements for funding workforce renewal have so far been a success in enabling Northern Powergrid to develop the skills of new employees rapidly enough to manage the uneven demographic profile of our workforce. But the five years of the DPCR5 period will be insufficient to complete this process. Therefore, the existing approach should be continued during the RIIO-ED1 period.
- **Cable fluid and SF6 leakage** - the current reporting arrangements for cable fluid and SF6 leakage should continue, although Ofgem will need to satisfy itself that the data is being reported consistently by DNOs. Northern Powergrid has significantly reduced cable fluid leakage over recent years, and we see no need for the arrangements to be revisited.
- **Business carbon footprint reporting** - DPCR5 introduced business carbon footprint reporting in a way that mirrors the reporting of many commercial enterprises. The heightened focus on this area achieves the objective of the measure, and Northern Powergrid believes that there is no need to revisit these arrangements.

23. There are also material areas in relation to financial issues, in particular tax and pensions, where DPCR5 established methodologies for setting allowances that remain appropriate at RIIO-ED1. We provide further detail on these below, in the section on financial issues.

24. Other areas are likely to require a greater degree of work, but not wholesale review. For example, the DPCR5 network outputs (now termed secondary deliverables) were an important innovation at that review which must now be developed further without giving rise to the risk of micro-management. A good example of how this can be avoided has been set by Ofgem's recent fast-tracking decision for the RIIO-T1 price control review, where secondary outputs will not directly influence financial rewards but will instead be used to inform the RIIO-T2 price control process. The information quality incentive (IQI) is also another

incentive which should be developed further compared to its implementation at DPCR5 (our ideas for how this could be done are set out in the section on assessing efficient costs below).

25. Finally, there are some other outputs and incentives that are likely to require more significant development. This includes the area of connecting low carbon technologies covered in the section above. It also includes the related areas of connections arrangements more generally (i.e. including demand connections) since there are significant cost boundaries associated with the current arrangements, and since independent distribution network operators (IDNOs) currently operate under very different rules that can distort connection pricing. Finally, the losses incentive is also in this category, where significant change compared to prevailing arrangements is likely to be required due to the roll-out of smart meters (see the section on smart meters below).

### *Financial issues*

26. Ensuring that the settlement can attract the necessary funds is one of the strategic imperatives that Northern Powergrid believes the RIIO-ED1 review must meet at a time of increasing infrastructure requirements globally. Transitional arrangements will also be required to help overcome the impact of longer asset lives on cashflows even absent any increase in investment needs.
27. Northern Powergrid welcomes the RIIO approach to establishing a relatively narrow range for the cost of equity at an early stage in the price control. This will help to provide greater visibility and certainty to investors.
28. The Ofgem consultation document is also clear that the cost of debt index and asset lives are policies which are now fixed, presumably in the absence of material changes to circumstances. Nevertheless, this change to asset lives will significantly slow cashflows. The use of a trailing-average debt index at a time when spot rates are rising from a long period of historic lows could also bite hard on financing requirements.

29. Northern Powergrid therefore believes that transitional arrangements for the change to asset lives are likely to be required as part of the price control review. There are a number of ways that these transitional arrangements could be implemented, including staged movement to the new asset lives (as is now being implemented for one company in the RIIO-T1 fast-track process) and also changes in the proportion of expenditure which is capitalised. Northern Powergrid believes that Ofgem should be willing to consider all of these options.
30. The approach to taxes and pensions is also always important in the context of a price control review. In these areas, the methodology established at DPCR5 remains appropriate and we believe it should continue to be implemented for RIIO-ED1. The DPCR5 pensions arrangements recognise adequately the provisions that the industry is tied into by the electricity sector pension schemes, with associated protected persons' rights. The specific circumstances of the schemes must continue to be recognised and the approach taken at DPCR5 must be followed at RIIO-ED1. The tax trigger mechanism is also a fair and useful system whereby some benefit is given back to end users over the course of the current price control period, while the incentive for companies to administer tax affairs efficiently is retained.

*Assessing efficient costs (question 3: how can we improve cost assessment?)*

31. Northern Powergrid believes that there are five objectives that Ofgem should take into account in order to ensure that the cost assessment process at the RIIO-ED1 review will be a success.
- Ensure that the benefits of equalised incentives are not confounded by the application of differential cost assessment approaches.
  - Address the potential distortions created by the cost boundary between the core price control cost base and connections business costs.
  - Place priority on developing totex benchmarking at an early enough stage that it can be implemented in the narrow window available.
  - Ensure that the benchmarking process is transparent to all stakeholders, so that the reasons and impact of adjustments are clear to everyone.

- Avoid cost assessment processes that could damage the incentives that the fast tracking process and the IQI create for developing challenging cost forecasts.
  - Continue to take into account evidence from wider sources, such as the market testing evidence which has played a role in RIIO-T1.
32. The equalisation of incentives across competing costs at DPCR5 was an important innovation that should help remove potential distortions in operating and reporting behaviour. This should bring benefits in terms of both more efficient operational practice, and improved data. However, in order to ensure these benefits are realised, the system of cost assessment must not create new sources of differential incentives between competing costs. This would be the case, for instance, if certain types of cost were subject to stricter benchmarking than others.
33. The current connections cost arrangements are a specific example of where similar costs are still being treated in different ways. These arrangements entail a significant cost boundary in indirect costs, with implications for both how costs are recovered and also for how they are assessed as part of the price control review process. This will increasingly become an issue the longer that this cost boundary exists, both in terms of how businesses structure their operations and in terms of the robustness of Ofgem's data collection and comparative efficiency work. The RIIO-ED1 review presents a timely opportunity to address these issues.
34. The development of totex benchmarking should be of significant benefit in the avoidance of cost boundaries that may distort assessment, and its implementation as an innovative part of the RIIO framework should be a priority. There are a number of methodological issues that should be considered during the policy-setting stage of the price control review. These include how to ensure that the methodology does not discourage any investment ahead of need which is in fact required, and how to ensure that any connections cost boundary cannot distort the results dependent on the size of the DNO's associated connections business. There are also some inputs to totex benchmarking that can be developed before the DNO business plans are published, and doing so will make its use in the initial assessment more straightforward. This includes the development of an

appropriate 'as used' measure of capital expenditure (i.e. capital consumption), since totex benchmarking involves an assessment of total expenditure that looks at capital expenditure on a backwards looking 'as used' basis as well as a forwards looking 'as built' basis.

35. Once company plans are published, the transparency of the information contained within them will be important in facilitating both Ofgem and DNO benchmarking exercises. We comment further on how this could be done in the section below on business plans and proportionate treatment. Ofgem's approach to transparency will also be important in ensuring a successful process. The cost assessment process at RIIO-ED1 should therefore be transparent to all stakeholders, in terms of data sets and adjustments that have been made, in a similar way to the close working between Ofgem and the DNOs at DPCR5.
36. As well as the high-level choice of methodology, there are many detailed aspects of cost assessment methodology that can significantly influence the outcome or the incentives that the methodology creates for the regulated companies. For instance, where targets are set at the lower of either the company forecast or the benchmark, over time this could detract from the incentives that fast tracking and the IQI create, since companies will know that, if they are not fast tracked, the industry wide benchmarking process will reduce their allowed costs by more if they have submitted challenging cost forecasts as part of their business plan than if they had not.
37. There also appear to have been important innovations in the cost assessment approach in the RIIO-T1 review. In particular, there appears to have been greater weight placed on evidence from market testing than has been the case at previous price control reviews, as was signalled by the RIIO handbook. This development is positive in that it takes into account direct evidence from the market as to whether the costs proposed by a DNO are as low as they could be, rather than indirect evidence from comparisons with other DNOs. This evidence is valid and should continue to be used by Ofgem in cases where a company has implemented an effective procurement process.

### *Smart meters*

38. As Ofgem notes, the installation of smart meters is likely to be a significant feature of the RIIO-ED1 period. There are four key issues relating to smart grids that Northern Powergrid believes the RIIO-ED1 review should consider.
- The impact of pre-existing issues with network and metering equipment on installation costs, and the appropriate sharing of costs between the DNO and the competitive market.
  - The impact that smart meters will have on DNO trading and billing systems, towards the end of the DPCR5 period or the start of the RIIO-ED1 period, which were not anticipated when the current price control was established.
  - The benefits that smart meters could bring once rolled out, provided that the chosen specification allows them to be exploited, which may be part of a longer term response to the flexibility and capacity challenges the industry faces.
  - The impact that the roll-out could have on other incentives and outputs during a period of transition, such as the losses incentive, IIS, current performance levels on guaranteed standards and expenditure required to ensure the network meets statutory requirements.
39. On the first of these issues, during the roll-out there will be additional costs as existing defects at and around meter positions are identified. At this stage, we believe that many of these costs will be associated with aspects of the meter installation that are not the responsibility of DNOs. But common agreement will be needed during the RIIO-ED1 review on which costs should be borne by the network operator, and which should be borne by the competitive market as part of the roll-out. Where costs are to be borne by the DNO, appropriate allowance should be made.
40. The roll-out will also have implications for DNO trading and billing systems. Depending on its exact timing, this could either be at the end of the DPCR5 period or at the start of the RIIO-ED1 period. While DNOs should be incentivised to contain the disruption and cost associated with the roll-out, no material additional

costs were anticipated at the time the DPCR5 price control was established, and so have not yet been funded through any price control.

41. Once the roll-out is completed nationally, Ofgem is right to note that smart meters should bring material benefits to the operation of networks, both in terms of outage data, and in terms of improved usage data that should help facilitate a better understanding of network capacity and flexibility, allowing 'smarter' operation of the network. Realising these benefits does, however, depend on the specification of smart meters adopted, and the bandwidth available for data transmission, both of which have implications for cost which must be borne in mind alongside the benefits.
42. However, Ofgem is also right to note that the period of transition could bring significant disruption to outputs and incentives that are currently in place in the DPCR5 period. Ofgem mentions the losses incentive, which currently takes as its starting point settlements data. There have already been material issues with consistency over time in how settlements data measures losses. For example, Northern Powergrid saw a steep increase in losses measured using settlements data received in the final year of the DPCR4 period, as electricity supply companies devoted more effort to correcting errors that have historically existed in the data. The roll-out of smart meters could uncover further material errors. Establishing targets and maintaining consistency of measurement for an incentive mechanism in these circumstances will be extremely challenging. The likely result will be that any efforts DNOs can make to reduce actual electrical losses will be drowned by changes in measurement error, which is not an effective starting point for any incentive. Our suggestions for alternative outputs on which an incentive could be based during the period of transition are set out in the section on potential outputs below.
43. There could also be implications for other outputs and incentives that will need to be considered at the review. For instance, changes to the measurement of outages could have implications for IIS, and for the cost of meeting the network reliability guaranteed standards. Since smart meters could mean that DNOs become immediately aware of low voltage outages that happen during the middle of the night, rather than in the morning when customers report them, the

restoration clock will start sooner on a subset of outages than is currently the case, with implications for the measurement of customer minutes lost and guaranteed standards. There will also be implications for customer interruptions, since the current approach to estimating the number of low voltage customers affected by a fault could be replaced by exact figures. Finally, the nature of the data provided by smart meters could reveal other issues with the network that must be addressed but which, at present, would be impossible to identify, such as voltage levels which fluctuate beyond statutory limits. Overall, while these issues are not currently as prominent as the implications of the smart meter roll-out for the losses incentive, it is still possible that the introduction of smart meters could cause material changes in the data used to incentivise DNOs on IIS, and also have implications for other outputs such as network guaranteed standards and statutory network requirements.

*Potential outputs (question 4: what are stakeholder views on potential outputs?)*

44. DPCR5 developed a set of outputs which covers many of the RIIO outputs categories. Many of these, though not all, remain appropriate for RIIO-ED1. Northern Powergrid's views are set out above in the section on DPCR5 mechanisms.
45. There are, however, some areas where outputs were not in place at DPCR5, or where they need significant revision to remain fit for purpose at RIIO-ED1.
  - **Outputs to support capacity and flexibility** - this is a key area for the review, and one where new outputs may well be required. Our views on potential outputs are set out above, in the section on low-carbon technologies.
  - **The environmental incentive to minimise electrical losses** - as set out in the section on smart meters above, the smart meter roll-out during the RIIO-ED1 period will cause continuity issues with the settlements data on which the DPCR5 losses output is based. During this period of transition, an alternative proxy for measuring losses performance should be used. This could for example involve using the change in estimated losses according to an engineering model. Although this is not an ideal output measure (since it

would rely on assumptions to translate inputs to outputs, rather than real world relationships), it would provide a consistent measure of losses which could be used without adjustment to incentivise the installation of low-loss equipment. Any such proxy arrangements should then be reviewed in future once the smart meter roll-out is completed and sufficient post roll-out data is available to establish target levels. This may be possible at the mid-period review of outputs for RIIO-ED1, provided that sufficient data following the smart meter roll-out is available.

- **Safety** - the role of the Health and Safety Executive as the regulator for safety across the whole economy means that this is an area that already has well-defined outputs and incentives for electricity network operators that stand outside the RIIO framework. However, these have not previously been explicitly monitored or incentivised as part of Ofgem's role as an economic regulator. We agree with Ofgem's stated intention that any safety output should be reputational at most, although even this should be given careful thought especially if Ofgem were to take these measures into account in fast-tracking decisions. These concerns aside, developing measures of safety performance should not be unduly challenging since there is already a reporting framework in place through the Reporting of Injuries, Diseases and Dangerous Occurrences Regulations 1995 (RIDDOR).
- **Social obligations** - there are certain social obligations where network companies are well placed to have a role. For instance, during a power cut a network company is likely to have information on the location and likely duration that means it is uniquely able to provide services to people who are vulnerable to the outage. All companies already hold a database of vulnerable customers, but there may be scope to increase the clarity of the service DNOs are expected to deliver to these customers. The customer service broader measure is an output which should capture aspects of the work DNOs do in this area, and should also help to incentivise improved performance in the future. However, for many other social obligations DNOs are far less well placed to deliver. For instance, DNOs do not hold the day-to-day relationship with electricity consumers which would allow discounts to be provided directly to fuel poor customers.

46. The Ofgem consultation document raises a specific question about whether there should be an output in relation to local authorities' integrated energy schemes. This may be appropriate but we believe it would be important for any such output to recognise that there may or may not be a demand for such schemes in particular DNO areas.

*Length of the price control (question 5: should ED1 last eight or nine years?)*

47. It is not immediately clear that there is a significant difference between an eight- or a nine-year price control. However, in coming to a decision on whether a change to the timing of the price control is worthwhile, all potential options should be considered on their merits.
48. While an eight-year price control is the default for RIIO, a nine-year control would mean that the GD2 and T2 reviews could be substantively completed before ED2 was started. It seems likely that running three price control reviews concurrently will not allow Ofgem to deploy its resources as efficiently or effectively as would otherwise be possible.
49. We do not believe that the disadvantages of running a longer price control would be major. While the changes in the electricity sector mean that there is greater uncertainty at RIIO-ED1 than has previously been the case, an eight-year price control with a mid-period review of outputs at four years does not seem materially different from a nine-year price control with a mid-period review of outputs at four and a half years. In either case, it will be important to ensure that the mid-period review of outputs is correctly scoped to ensure it can deal effectively with the uncertainty at RIIO-ED1 while ensuring that there is credibility about the extended price control period. Too wide a mid-period review scope, and it will undermine the benefits of a longer price control review period. Too narrow in scope, and it will make it more difficult to take into account rapid developments in the electricity sector.
50. The other clear alternative that would achieve the same objective of creating a larger timing difference between the two price control reviews would be a one-year price control roll-over. This could be of significant benefit if it were made as

light touch as possible, and settled early and efficiently, in order to prevent creating a distraction from the ongoing full price control reviews. In this regard, the approach taken to the TPCR4 roll-over does not appear to be one that should be repeated, especially since it would reduce the credibility that the mid-period review of outputs during RIIO-ED1 will genuinely be light touch, and not a mini-review. A roll-over would also bring one other benefit, which is that it will allow greater time for the lessons that are emerging from the LCN fund to be built into company business plans.

*Business plans and proportionate treatment (question 6: what improvements can be made to the process at RIIO-ED1?)*

51. There are four key areas that Northern Powergrid believes will be important in ensuring the business plan and proportionate treatment process is a success.
- The fast-tracking process must limit the degree to which business plans can be revised, to strengthen the incentive to submit a cost effective plan at the first attempt.
  - The IQI should be retained, and could be strengthened even further through how it is implemented.
  - Business plans would benefit from easier cross-referencing by stakeholders, as Ofgem observes.
  - The DPCR5 performance assessment should be undertaken carefully and given appropriate weight, to prevent it obstructing the process.
52. RIIO-ED1 will be the first review where the proportionate treatment and fast-tracking process can be fully implemented as intended under RIIO. At RIIO-T1, iterative feedback has been provided to transmission companies in a way that was not envisaged under RIIO. At RIIO-GD1, external factors have compressed the timetable for proportionate assessment. Finally, DPCR5 established outputs and incentives in many of the areas envisaged under the RIIO framework, giving a relatively well-developed baseline against which to judge past delivery performance. In this context, ensuring the proportionate treatment process works effectively will be an important step in the full implementation of RIIO.

53. While it was appropriate, given the new process, to provide iterative feedback to transmission companies on their business plans after initial submission, this should not continue to be a feature of the RIIO approach. Allowing companies to be fast tracked following significant change to their plan, or significant provision of additional information to Ofgem, weakens the incentive to submit a well-justified business plan at the first attempt. In order to ensure that the incentive to develop a well-justified business plan for initial submission is as strong as possible, the process should only allow for tweaks to the detail towards the end of the process when Ofgem has satisfied itself that the big picture is right.
54. The IQI is the other incentive which Ofgem uses to encourage companies to submit challenging cost forecasts at the first attempt. Although it was retained at the RIIO-T1 and GD1 reviews, it could be strengthened at the ED1 review by giving a clear signal early in the process that rewards will not be influenced by reductions in cost forecasts that take place between initial and final submissions (for companies which are not fast tracked), and that these rewards will rapidly diminish where companies appear to be self selecting into a high-baseline, low-risk environment.
55. In terms of the business plans themselves, Ofgem has signalled that it intends to use the same guidance as was in place at the GD1 and T1 reviews, but that it is also seeking to make plans more consistent in structure, levels of disclosure, and in terms of how longer term investment is justified. While we believe it is important for DNOs to have scope to present the information they feel is most relevant to their business plan, we also support Ofgem's objective of making the plans more consistent and navigable. For those stakeholders who need to become familiar with the plans of all companies in a short space of time to make proportionate assessment possible (including Ofgem, the DNOs themselves, energy supply companies and organisations such as Consumer Focus) a greater degree of consistency in presentation should help to make the process more efficient.
56. Finally, as well as an assessment of the business plan and proposed costs, the proportionate assessment process also involves an assessment of historical performance at delivering outputs. It is important that this assessment focuses on information that is germane to the setting of the forthcoming price control review,

and therefore is not mechanistically applied. While DPCR5 provides many of the key outputs that will be required for RIIO-ED1, some are still in the implementation phase, and for others Ofgem will only have two years' worth of DPCR5 period data by the time the strategy document is published. Care must therefore be taken in undertaking this performance assessment to ensure that all the available evidence is taken into account, in order to focus only on genuine issues.

*Company stakeholder engagement (question 7: feedback on T1, GD1 and ED1 stakeholder engagement processes)*

57. In the past, stakeholder engagement only fed into company business planning to a limited degree, through willingness to pay and consultation exercises. A key feature of RIIO is therefore that stakeholder views take on a much greater role.
58. Northern Powergrid welcomes Ofgem's call for feedback on stakeholder engagement processes used in RIIO-T1 and RIIO-GD1. Where there are lessons to be learned from the experiences of all those who have participated in the process implemented by the companies taking part in those reviews, effective sharing of these lessons could improve stakeholder experiences in the future.
59. In terms of lessons from our own stakeholder engagement process, it is clear to us that stakeholder engagement needs to be built into ongoing business practice to enhance the ability that stakeholders have to influence the service levels we offer in those areas where we interact with end users regularly. During 2011, for example, Northern Powergrid held nationally promoted workshops for distributed generation customers, and we expect to hold further events of this nature in the future. The ongoing nature of these stakeholder engagement processes within price control review periods is likely to be just as important in ensuring stakeholder views are taken into account as effective stakeholder engagement at the price control review.

*Stakeholder engagement groups (question 8: could improvements be made to the proposed stakeholder engagement groups?)*

60. Stakeholders who have taken part in the reviews will be able to give definitive feedback. However, from an external perspective, these appear to have been fit for purpose in achieving their objectives, and so we support Ofgem's proposal to continue using a multi-layered approach involving the Price Control Review Forum, the Consumer Challenge Group and working groups on specific issues.
61. In terms of the proposed specific working groups, the list presented at Annex 4 appears appropriate in that it gives good coverage of the topics RIIO-ED1 must consider. However, the potential overlaps between some working groups will require clearly defined terms of reference and a process which facilitates the joining up of working group thinking. The clearest example is the flexibility and capacity working group (which must consider the connection of low-carbon demand and generation) and the more general connections working group.
62. Finally, there is one related aspect of the role of stakeholders in the price control process that may require some clarification. RIIO introduced the opportunity for stakeholders to make modification requests that Ofgem could then refer to the Competition Commission. Ofgem subsequently recognised that its guidance on this may need to be revised once legislative changes had been made to the process for licence modification. These legislative changes are now complete and have granted key stakeholders, such as the National Consumer Council (i.e. Consumer Focus) and other licensees who are materially affected, the opportunity formally to appeal price control decisions. The legislative changes have also removed Ofgem's ability to make references to the Competition Commission, which was part of the original modification procedure. In light of these changes, the guidance for third party modification requests needs to be updated. Given this, it would be worthwhile considering whether any appeal rights beyond those formally granted in law are in fact required or indeed consistent with the new statutory arrangements.