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By email to: RIIO.ED1@ofgem.gov.uk

2 April 2012

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 provide views on Ofgem's proposed way forward for the next electricity distribution price control review (RIIO-ED1).

This response should be regarded as a consolidated response on behalf of UK Power Networks' four electricity distribution licence holding companies: Eastern Power Networks plc, London Power Networks plc, South Eastern Power Networks plc, and UK Power Networks (IDNO) Limited.

I can confirm that this response is non-confidential and can be published via the Ofgem website.

In the attached pages, we have responded to each of the questions shown in 'bold' in the open letter. However, I would like to take this opportunity to share UK Power Networks' views as to the key strategic issues for RIIO-ED1.

The RIIO framework was established in recognition that the energy networks are entering a period of transition. The simple reliance of homes and businesses on fossil fuels is gradually being broken and we face fundamental changes in the ways we live and work.

The electricity distribution industry is right at the centre of these changes and while the destination is becoming clearer, the timing and pace of change is less so. Certainly over the next 10–20 years, there will be a constant challenge to ensure that we are investing in the right technologies for the future, consistent with society's needs and at the lowest long-term costs for our customers.

In many respects, our three regions are a microcosm of the UK. We encompass the most economically active areas in the UK, together with areas of significant population growth. Yet we also have highly rural areas of growing importance for onshore wind and other renewable energy sources. Hence the priority for UK Power Networks must be meeting the immediate needs of customers and stakeholders, whilst making significant steps along the road to a low carbon economy.

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A key consideration, particularly within the M25 but also in other economic centres, is the ability for developers/generators to connect to our networks. We are currently putting significant investment into our connections processes to improve the customer experience; however, if capacity constraints restrict our ability to make that connection, then customers will ultimately be disappointed. Hence, echoing the importance that Ofgem attaches to connections customers, we recognise that RIIO-ED1 will need to address the Time/Cost to Connect, which will require both traditional reinforcement and the deployment of new technologies/commercial arrangements.

In the letter, Ofgem raises the potential to roll forward approaches and mechanisms from DPCR5 where they are seen to be working effectively. In principle, we would agree that this is a sensible strategy; however, we would identify the following as requiring change prior to them being acceptable for RIIO-ED1:

- **Losses:** We believe that the roll-out of smart metering will result in significant disruption in the reporting of losses and hence companies could be faced with considerable uncertainty which will be largely outside their control. In light of this we would like to propose that either this incentive is limited such that it is only applicable to technical losses and/or the incentive strength is very substantially reduced.
- **Network Output Measures:** Considerable progress has been made in developing the existing health and load indices; however, if these are to fulfil their potential as tools for asset management, it is important that they are developed further. Not all assets have the same significance within our network: while many will be relatively stable in their usage, some are particularly critical due to the customers that are connected, whereas others are subject to rapidly increasing demand. Current best practice in network asset management uses measures of criticality and priority to provide best value for money within DNOs' investment plans.
- **Broad Measure of Customer Satisfaction:** UK Power Networks agrees with Ofgem's desire to make customer satisfaction a fundamental measure of DNO performance. However, our view is that the existing Broad Measure simply does not go far enough in terms of capturing the diverse range of interactions we have with our customers. We look forward to sharing our ideas about how this might be enhanced further.
- **DG Incentive Framework:** We agree with Ofgem that improving the process for connection of DG to our networks is a crucial test for RIIO-ED1. As such, we would like to see the existing incentives associated with DG brought together into a single framework, and for this to be extended to cover approaches such as Demand Side Management. We would also favour a stronger incentive being placed on this, thus recognising its likely importance in the years to come.

While we will bring forward plans for the introduction of smart grid technology onto our networks, we will also need to respond to low carbon initiatives which are outside of our control. Smart metering is a significant opportunity for our industry, albeit that we do not have direct responsibility for the roll-out. It will generate a requirement for large numbers of small interventions, as meter installers identify networks-related tasks. If customers are to remain on board with this change, the DNOs and meter installers will need to find ways of working together which ensure a reasonable customer experience.

However, once smart meters are in place, there will be a revolution in the information that is available to DNOs about the operation of their networks. To take two simple examples, being informed instantly that a property has gone off-supply will transform a DNO's response to a network fault. Likewise, the better understanding we will have of real time demand will enable us to identify potential network constraints with far more precision and therefore be more specific with our network investment.

Of course, securing these benefits will require a very significant investment in our IT systems, to accept and process this data and major changes to business processes so as to capitalise on this knowledge. This business transformation will be a significant priority for RIIO-ED1 and probably ED2 also. UK Power Networks has been very active in the joint DECC and Ofgem Smart Grid Forum work streams and has already begun to enhance its network investment planning capability and systems so as to be able to reflect the future network requirements in the RIIO-ED1 business plans.

Other green developments are likely to have a profound impact on our networks and raise some important questions about the future role of DNOs. Electric vehicles and small-scale generation will place extra stresses on our network management systems, but we believe that there is a clear responsibility for us to do what we can to ensure that electricity distribution networks do not constrain their uptake.

A range of choices may well emerge during our discussions with customers and stakeholders, and it is important to understand the extent to which DNOs should be proactive in addressing these issues. UK Power Networks recognises the additional commitment that this engagement places on external stakeholders and would suggest that where there are common issues across the industry (connection charging, use of system charging etc), DNOs should work together to establish stakeholder opinions and requirements. However, as stakeholder engagement remains a key component of being able to differentiate excellent DNO performance from average DNO performance, DNOs should remain free to develop their own stakeholder engagement processes and policies. UK Power Networks will continue to leverage on its business-as-usual stakeholder engagement from the first two years of the current price review to ensure that its business plan for RIIO-ED1 reflects the collective expectations of stakeholders and customers' willingness to pay.

I hope that you will find our response helpful. If any aspect requires further explanation or clarification, please do not hesitate to contact me.

Yours sincerely

Keith Hutton
Head of Regulation
UK Power Networks



Appendix 1

Question 1: Do you agree that ensuring that DNOs accommodate low carbon technologies in a timely and cost effective way should be a key objective of RIIO-ED1? Do you have any thoughts on how we could address this?

UK Power Networks strongly agrees that a key objective of this price control should be to create an environment in which the electricity distribution industry can play a full part in the development of a low carbon economy. This is reinforced through our engagement with stakeholders, which indicates clear support for the embracing of low carbon technology. Even our domestic customers are of the view that a company such as ours should be seeking to operate with the most modern technologies and demonstrate leadership in this area.

However, while we would unambiguously support this strategy, it is worth stating that this will require a variety of changes to the regulatory contract and, due to the potential complexity of these, we welcome the early start to discussion of these issues. Below we have set out some of the areas that we believe are worthy of further discussion:

Innovation: We believe that the Low Carbon Network Fund was one of the major successes of the DPCR5 review and welcome Ofgem's commitment to its continuation in the form of the Network Innovation Competition and Allowance. It is our view that there will continue to be a requirement for such a scheme for the foreseeable future, and new challenges will emerge as the transition to a low carbon economy progresses.

Incentives: We believe that some well constructed incentives could be helpful in encouraging the industry to embrace low carbon technologies and/or the use of innovative commercial arrangements. While we do not underestimate the difficulty in designing such an incentive, it seems logical to consider an arrangement that recognises the value of traditional asset reinforcement that can be avoided through their use.

Outputs: Our stakeholder engagement has shown very strong support for a 'Time to Connect' output measure which we believe should encompass generation as well as demand. Such a measure could provide a useful incentive for DNOs to adopt new technologies, benefiting both generators through improved time/cost to connect, and broader consumers through reduced asset reinforcement.

Capacity: While low carbon technologies will, in some circumstances, enable DNOs to avoid network investment, the desire of end-users to deploy low carbon technology may well have the opposite effect. UK Power Networks has traditionally sought to run its networks at a relatively high level of utilisation compared to some other DNOs, as we believe this offers the most efficient outcome for consumers. However it should be recognised that enabling our customers to make use of new technologies in their operations may require some targeted investment to increase the capacity of the network.

People: The roll-out of smart meters, smart grids, and a changing relationship between DNO and end-customer, will mean that the network companies will have to adapt their operations, and with that reshape and reskill their organisations. We believe that the Workforce Renewal funding that was provided as part of DPCR5 has proved an extremely valuable initiative in addressing the problems of an ageing workforce. We would like to see a continuation of this investment in RIIO-ED1, but targeted to developing the skills base within the company to reflect these new priorities.



DNOs as a catalyst for the adoption of low carbon technologies: An important question for this price control will be just how far our customers and stakeholders want us to go in driving the transition to a low carbon economy.

To take a hypothetical example, what role should a DNO take in supporting the adoption of electric vehicles? Clearly we could remain relatively passive in this process, merely responding to connection requests from other providers such as local authorities. A step beyond this would be to integrate a requirement for widespread charging into our network strategy and design, and hence factor this into our general reinforcement plans. The ultimate step might be to propose the proactive roll-out of charging infrastructure across some or all of our network areas.

We plan to undertake extensive 'willingness to pay' research and the example above would be a very obvious area to debate with customers.

Another strategic question which will accompany the roll-out of smart meters is how the networks will respond to the challenges of demand side management. There are many questions in respect of the aims of DSM: for example, is it generation optimised or network optimised? How are customers incentivised? And by whom?

Both of the examples above demonstrate that there is an important strategic debate to be had regarding the long-term role of the DNO, and this will have major implications for RIIO-ED1 and beyond.

Question 2: Which of the DPCR5 outputs and incentives do you consider to be fit for purpose, or require minimal amendment, for RIIO-ED1?

As a general principle, UK Power Networks does not believe in 'reinventing wheels'; hence if something is working well, and it still fulfils a purpose, we would be happy to see it continue into RIIO-ED1. In response to a previous request, UK Power Networks has provided Ofgem with its thoughts on incentives – a copy is attached as appendix 1.

In summary, we believe that the introduction of smart technology will have a substantive impact on a number of the existing incentives. In addition, we would like to see changes to a number of the more customer-oriented incentives to strengthen their focus and also to ensure that they are reflecting the requirements of all customers. In light of that, there are probably relatively few of the incentives that require little or no change at all.

In respect of Outputs, DPCR5 has been a learning exercise for the industry as we move towards a more output-led regulatory framework. A significant amount of time has been invested in the development of the health and load indices; however we believe that these require further work, in respect of priority and criticality, to make them truly meaningful. We look forward to continuing our discussions with Ofgem around this subject.

Furthermore, in autumn 2011, UK Power Networks undertook a major process of engagement with its customers and stakeholders on the subject of Outputs. We look forward to presenting these findings within the appropriate ED1 working groups and they are available to view on UK Power Networks' stakeholder engagement website.



Question 3: We welcome respondents' views on how we can improve the cost assessment, particularly with respect to the expenditures that will be proposed in RIIO-ED1.

UK Power Networks is content with the principle expressed elsewhere that methods etc should be carried forward from DPCR5 if they are seen to be effective. However, cost assessment is one area that we believe requires greater consideration.

The DPCR5 process, with its heavy reliance on disaggregated regression analysis, had serious limitations. We welcome Ofgem's shift of focus to the assessment of forecast costs, rather than the past, mechanistic approach to setting allowances, based on historic costs.

We strongly support the proposed use of a toolkit and would expect this to include the following:

- Totex analysis
- Limited disaggregated historic cost benchmarking
- Unit cost analysis
- Expert review (as undertaken for IT and Property costs in DPCR5)
- External comparators (DNOs demonstrating the validity of their proposed costs, either through commercial methods such as tendering or proactive benchmarking against other comparable organisations)

As a general principle, we also believe that the content of the business plan should be central to Ofgem's judgements on efficiency. A 'well justified' business plan should be explicit in demonstrating how, for example, regional factors or decisions regarding insourcing and outsourcing contribute to the forecast costs presented. One could argue that presenting a credible set of well justified forecast costs should have greater weight than an analysis of historic costs, and hence the time devoted to such assessment should reflect this.

We are strong supporters of a move to totex-based analysis, as we believe that increasingly DNOs will have to adopt a mix of opex and capex solutions to ensure they are delivering value for money to our customers. The assessment tools deployed, not only in price controls but also by the companies themselves in their asset management processes, will need to change to reflect this more complex world. Having said that, we do not underestimate that delivering a totex assessment model will be challenging. We are actively thinking about how this might be pursued and look forward to sharing this with Ofgem

Question 4: We would be interested to hear stakeholders' views on potential outputs, for example what might be included in the social obligation category, and whether it would be useful to set outputs related, for example, to the role DNOs might play in Local Authorities' integrated energy schemes.

As mentioned earlier, UK Power Networks has already undertaken an initial round of engagement activities concerned with Outputs. To address the question relating to the Social Obligation category, our experience is that customers actually view the delivery of our core activity – cost-effective provision of electric power – as having significant social benefit in its own right. However, we do recognise that there are certain classes of customer who are particularly impacted by any loss of supply. It may be possible to construct an output measure which recognises the treatment of such customers.

Other alternatives suggested by stakeholders include:

- A 'broad measure' of corporate social responsibility which might encompass measures such as community involvement, charitable activity, education etc
- A measure of the 'health' of our supply chain or our employees

There are a number of local authority integrated energy schemes being planned or piloted in our regions and in some cases we have had some dealings with them through our routine activities or through our LCNF project, Low Carbon London.

While our engagement with local authority stakeholders has not highlighted specific opportunities for Outputs related to such schemes, we would be open to discussing whether outputs could be devised relating to our involvement in these. However, one would have to debate whether these are more closely linked with an environmental output rather than a social one.

Question 5: Do you think the ED1 price control period should last for eight or nine years?

We recognise the resource constraints that Ofgem must face as a consequence of the overlap between the T1, GD1 and ED1 price controls. Hence the proposal that RIIO-ED1 should be a nine year price control seems to be a pragmatic step to address this problem going forward and one that UK Power Networks would readily support.

The obvious alternative to this would be a rollover of DPCR5 arrangements for an extra year; however, UK Power Networks would not support this. It is our experience from the stakeholder engagement we have undertaken in preparation for RIIO-ED1 that many stakeholders are keen for us to move into the RIIO period. They see the new framework as an opportunity to update the drivers for network investment for both traditional infrastructure and low carbon technologies. We believe that many stakeholders would be very disappointed to see a one year delay, driven by what might be perceived as administrative convenience.

Question 6: We welcome feedback on the business plans and proportionate treatment process for RIIO-T1 and GD1 and any improvements we can make for RIIO-ED1.

It is evident that all of the companies have invested a significant amount of time and effort in developing their business plans; however, as an external stakeholder, we did not always find it easy to follow the rationale behind the plans. In some cases this was because the plans were not clear in demonstrating the link between proposals, outputs and costs, together with the decision-making processes that underpinned these. In other cases, there was obvious redaction of material which severely impeded our ability to understand what was being presented.

In both of the above cases, we are pleased that Ofgem has noted these concerns – for our part, we will do what we can to learn from T1 and GD1 and hence make our business plans as accessible as possible.

Equally we would make similar criticisms of the proportionate treatment process. We are very supportive of Ofgem's intentions in this area but the documentation published in relation to T1 and GD1 has not always been entirely clear as to the assessment processes that have been adopted. Hence, in RIIO-ED1, we feel that the industry would benefit from greater clarity over how assessments were arrived at. This should enable the companies to be much more responsive in addressing those areas where Ofgem has questions or concerns.



Question 7: We welcome feedback on the company stakeholder engagement processes used in RIIO-T1 and GD1, and also welcome any feedback on the consultations being initiated by the DNOs.

While we have attended a number of engagement events as part of the transmission and gas distribution price controls, we are largely dependent on the written documentation produced to assess the relative merits of the different approaches.

Our perception is that all companies have paid serious attention to the views of stakeholders, as demonstrated through the extent of events, interviews and online activities. However, what is harder to discern is the decision-making process that these opinions presumably fed into, and the extent to which any of these have survived in the form of concrete initiatives within the business plan. This audit trail, from raw opinion through to costed proposal, is something we will attempt to address very directly in our ED1 business plans.

As Ofgem is aware, UK Power Networks has had a dedicated programme of stakeholder engagement in support of the development of its ED1 business plans for the last year. In 2012, this activity will only increase as our business plan proposals start to take shape and we undertake further engagement around outputs and targets, options and discretionary activity, and formal 'willingness to pay' research.

Question 8: Have these stakeholder engagement groups been useful in RIIO-T1 and GD1? Are there any improvements that we could make for RIIO-ED1?

It is our impression that the stakeholder engagement processes adopted by Ofgem in the RIIO-T1 and GD1 price controls have been beneficial, and we are supportive of the Price Control Review Forum and Consumer Challenge Group continuing into RIIO-ED1.

The model of working groups which Ofgem has proposed for RIIO-ED1 seems sensible, and perhaps the only suggestion we would make is that Ofgem attempts to encourage some external stakeholders to participate in certain groups.



Appendix 2: UK Power Networks Priorities for Incentive Arrangements

DPCR5 No	DPCR5 Incentive	Output (main)	UKPN Proposed RIIO-ED1 Incentive	UKPN Priority for Change	Criticality for Change in RIIO-ED1	Complexity of Change	Stakeholder Comments
6	Losses Incentives	Environmental	Reduce incentive strength to focus on value of technical losses or suspend until after 2019 to reflect data quality uncertainty within smart meter roll-out.	1	High	Low	Some stakeholders have identified the need for a more focused measure on Technical Losses.
7	DPCR5 losses rolling mechanism		Extend the agreed DPCR4 principles		High	Low	
New A	Facilitation of decarbonisation of UK economy	Environmental	Enhance methodology to include a reduction in LIs for DSM and Smart Grid application (including network back-up generation).	2	High	High	Stakeholders agree that a reduction of CO ₂ emitted through investment choices is a good output measure but are unsure if this is truly measurable. An alternative incentive could be to look at the option value of SG investment.

New B	Connections	Connections	Incentive on time to connect as well as standard of performance	3	High	Medium	Our stakeholders' view is that there should be flexibility to meet all stakeholders' requirements, not just the performance against set timetables. For example, certainty of delivery was seen as more important than delivery timescales by some stakeholders.
18	Network Output Measures	Network availability/reliability	Revise to include Criticality for HI and Priority for LI	4	High	Medium	Recognising stakeholder requirements – LI needs to recognise pace of change for Demand Connections (infrastructure ahead of need) and DG Connections – HI needs to recognise Customer/Safety criticality of assets.
12	Broad Measure of Customer Satisfaction	Customer Service	Extend scope to recognise all customer expectations	5	High	Medium	Broaden scope of customers engaged, which was supported by stakeholders.

3	DG Incentive Framework	Environmental	Review incentive strength and recognise DSM explicitly. This could incorporate the provision of information to DG customers.	6	High	Medium	This will also require revisions to P2/6 standard. UK Power Networks is looking to work with ENW and Imperial College to develop P2/7 (and modify ETR-130)
20	Information Quality Incentive and Risk/Reward		Review scope and incentive strength	7	High	Medium	N/A
New C	Streetworks	Social Impact	Implementation of common standards across all DNOs reflecting TMA and lane rental standards	8	High	High	Stakeholder support, particularly domestic customers, has not yet been evidenced.
2	DG Provision of Information	Customer Service	Implement a common methodology across all DNOs – could be incorporated into DG incentive framework	9	High	Low	Supported by 2011 stakeholder engagement

11	Connections Competition	Connections	Implement agreed DPCR5 recommendations for extension to contestability	10	Medium	Low	Stakeholder views and requirements, including those of ICPs and IDNOs, have been incorporated into UK Power Networks' revised Competition in Connections policy and procedures.
15	Interruptions Incentive Scheme	Network Availability/Reliability	Carry forward with minor changes	11	Medium	Low	Strong stakeholder support to consider short interruptions inclusion within incentive. Also to review impact of metal theft, exceptional events, smart metering information and benchmarks to recognise automation performance.

16	Network and other GSoP	Customer Service	Extend scope	12	Medium	Low	Stakeholder support to revise thresholds of payments to recognise the impact on different customers (18 hour failure). May need to revise standards as a result of smart meter roll-out
14	Worst served customers	Social Impact	Increase incentive strength to better reflect the network costs of improvement	13	Medium	Low	Broadening the measure is supported by 2011 stakeholder engagement.
5	Transmission connection point charging		Could be replaced if competition is extended within transmission use of system to ensure cost pressure is maintained	14	Medium	Low	N/A
1	Low Carbon Network Fund	Environmental	Implementation of Networks Innovation Competition (NIC)	15	Low	Low	Stakeholders are broadly supportive of the extension of the scheme to other parties

8	Business Carbon Footprint Reporting	Environmental	Replace if incentive relating to facilitation of decarbonisation of the UK economy is introduced	16	Low	Low	Note: London has a high density of FFC; stakeholders believe it is important to reduce SF6, oil leakage
9	Areas of Outstanding Natural Beauty	Environmental	Carry forward	17	Low	Low	There is stakeholder support to extend this to cover undergrounding in other areas on grounds of visual amenity.
10	Connections GSoP	Connections	Could be replaced by a general measure on Time to Connect or carry forward as is.	18	Low	Low	Does this now need to be rationalised?
4	Use of system charging for pre-2005 DG	Customer Service	Implement agreed DPCR5 recommendations	19	Low	Low	
19	Innovation Funding Incentive	N/A	To be incorporated into NIC	N/A	N/A	N/A	
13	Telephony Incentive	N/A	Withdrawn	N/A	N/A	N/A	
17	Customer Service Reward Scheme	N/A	UKPN proposes to withdraw the incentive	N/A	N/A	N/A	Recognise stakeholder comments and replace with Broad Measure of Customer Service