

Low carbon technologies and smart grids

**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?**

We agree that a key objective of RIIO-ED1 will be to accommodate low carbon technologies in a timely and cost effective way. The next price control period to 2023 is likely to be an important period for the UK energy sector and WPD fully recognises that sustainable networks are central to the significant energy challenges ahead.

Over the period of the next price control we expect to see an increased take up of low carbon technologies including heat pumps, solar panels, electric vehicles and small scale renewable generation. Whilst the major drivers of network change and sources of uncertainty over the coming years is now better specified the challenge for Distribution Network Operators (DNOs) will be to continue to develop networks that are reasonably future-proof given that what we do not yet know is the scale of this requirement with any certainty. It would be wrong to embark on a wholesale alteration to our network for a speculative outcome and the development and implementation of innovative approaches and technology via funding mechanisms such as the Low Carbon Network Fund (LCNF) will therefore continue to be a key part of ensuring that networks can plan for the future rather than react in a way that provides too little too late. Given the degree of uncertainty that exists, we believe incremental/generic changes are most flexible. For the foreseeable future networks that evolve in response to reasonably demonstrable user need seem the most efficient approach.

We agree that we need to consider a range of potential future scenarios in our business plan but we do not envisage major structural change in the network within the RIIO- ED1 period. Our business plan will explore in depth the role that smarter solutions could play in supporting the change to a low carbon world both within and beyond RIIO-ED1 and as part of the business planning process we have recently published an innovation strategy setting out our approach (See Appendix 1). Our strategy is based on the premise that innovation must always be compatible with the existing network if we are to provide future networks that are more efficient, cost effective and reliable for our customers.

WPD will therefore focus on four key goals:

- Efficiency and reliability: We will continue to use innovation to operate the existing electricity network more effectively.
- Flexibility: We will develop technologies to accommodate increases in electricity demand and changes in customer behaviour.
- Trial and testing: We will research and develop innovative ideas by carrying out practical trials of new technologies.
- Large scale roll-out: We will turn successful trials into products and ways of working that can be applied across our network and that of other DNOs and used as business as usual.

The regulatory framework needs to support innovation and flexibility by providing the funding needed to implement the necessary steps.

Whilst the level of expenditure to facilitate DG remains uncertain we anticipate that provided the strength of the DG incentive is sufficient, project specific reinforcement costs arising from new connections should mostly be covered via the DG incentive.

The area for concern is where there is a high take up of DG electric vehicles or solar or heat pumps. The outputs of LCNF projects will help us develop innovative ways to deal with the changing pattern of demand and generation but it may be that very intense pockets of activity do not match the outputs. In those cases, and where innovative solutions do not provide a full answer, traditional reinforcement will remain a valid option. A significant variance against a forecast could increase the reinforcement programme of the LV HV or EHV network depending on the technology. The best way to handle this would be to ensure that outputs are kept constantly under review as part of the RRP process together with an agreed procedure or mechanism for modification should material new information come to light.

Review of DPCR5 mechanisms

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

We agree that many components of the DPCR5 package are working well with only minor adjustments required. The following table sets out the output and incentive mechanisms incorporated into the DPCR5 package and WPD's view of whether changes are required.

| <b>Outputs/<br/>Incentive</b> | <b>Description</b>                   | <b>Minor changes needed</b>  | <b>Significant review needed</b>  |
|-------------------------------|--------------------------------------|--|---|
| <b>Reliability</b>            | Interruption incentive scheme        | Changes to targets and incentive rates only                                |   |
|                               | Worst served customer mechanism      | Consider changes to the definition of a worst served customer              |   |
|                               | Health indices                       | A common understanding of the definition of each HI is required            |   |
|                               | Load indices                         | Consider a common definition and introduction of a forward looking element |   |
| <b>Customer satisfaction</b>  | Broad measure survey                 | Unlikely, suggest review after one year of operation                       |   |
|                               | Broad measure complaints             | Comparisons based on actual complaint numbers not percentages              |   |
|                               | Broad measure stakeholder engagement | Unlikely, suggest review after one year of operation                       |   |
|                               | Guaranteed standards                 | No changes   |   |
| <b>Connections</b>            | Guaranteed standards connections     | Resolve the 90 day and 65 day conflict                                     | Yes. The standards are very complicated and may not be delivering customer benefits in the right areas. |
|                               | Connections - competition and margin | Unknown until the competition tests have been completed                    |   |
| <b>Environment</b>            | LCNF/innovation funding              | Review new fund after introduction. Consider introduction of a             |   |

|                               |                                     |  |                              |
|-------------------------------|-------------------------------------|--|------------------------------|
|                               |                                     | mechanism for change for existing projects                                     |                              |
|                               | DG information                      | No changes   |                              |
|                               | DG incentive                        | Dependant on the output of the flexibility and capacity working group          |                              |
|                               | Transmission exit charges           |  | Yes, no incentive properties |
|                               | Losses incentive                    |  | Yes, no incentive properties |
|                               | Business carbon footprint reporting | No change  |                              |
|                               | Undergrounding in AONB              | No change, agree allowance only  |                              |
| <b>Allowance setting</b>      | IQI mechanism                       | Need to understand how this will work with scenario planning required for RIIO |                              |
|                               | RORE calculation and use            | No change  |                              |
| <b>Uncertainty mechanisms</b> | Reinforcement                       | No change  |                              |
|                               | Traffic management act              | Include lane rental  |                              |
|                               | HILP                                | No change  |                              |
|                               | CNI & Blackstart                    | No changes   |                              |
|                               | Rising & Lateral Mains              | No change  |                              |

The two key components of the package that require a significant review are the losses incentive and simplifying the connections Guaranteed Standards of Performance and this is covered in more detail in our response on the section of outputs.

In relation to uncertainty mechanisms, our early view is that the uncertainty mechanisms for RIIO ED1 should broadly reflect the uncertainty mechanisms that we have in place currently. Government policy and regulatory changes should be the primary driver of any additional re-opener mechanisms. In addition to the mechanisms identified at DPCR5 there are also potentially future significant uncertain costs associated with the smart meter roll out. We think there is a strong case to ensure there is an uncertainty mechanism for the smart meter roll out within the RIIO-ED1 package.

Assessing efficient costs

**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**

Ofgem correctly identify that companies must deliver increased investment over the next price review period for a range of reasons. WPD recognises the potential challenges of the low carbon future and the LCNF projects provide a useful view of how to prepare for that future however we should not get carried away with fanciful estimates of cost and above all recognise that that future will only be delivered by companies that can deliver engineering projects at efficient costs and in a timely way. The current omens are not good with the average DNO being 30% behind their DPCR5 capital program despite in most cases that program being less than requested in their original business plan. It is also the case that some of the LCNF tier 2 projects are failing to deliver. It is against that background that Ofgem need to understand the detail of proposals made in order that customers do not pay for unnecessary network investment nor at inefficient levels of unit cost. It is vitally important that we do not return to high level regression analysis based on statistically determined cost drivers but continue the Regulatory Reporting (RRP) process revealing accurate consistent costs coupled to logically derived cost drivers.

Ofgem has progressively moved to a more detailed examination of costs through RRP and we welcome that approach since that together with a logical view of what drives those costs is the method WPD has used when considering acquisitions. We have on many occasions expressed our concerns of high level Totex regressions which in our view only serve to protect the inefficient.

We have shared our modelling at all levels of Ofgem prior to any thoughts related to our recent acquisition of Central Networks. That modelling revealed CN inefficiencies of over £70m per year and that both CN East and CN West were equally inefficient at the 30% level compared to WPD South West and Wales.

Regressions at DPCR5 showed wildly differing level of efficiencies between CN East and West for two companies run in the same way with shared overheads and systems. DPCR5 final proposals showed CN East was viewed as third and CN West thirteenth in the efficiency league. WPD South West and Wales were 4<sup>th</sup> and 9<sup>th</sup> respectively in that same DPCR5 analysis.

What we have found in reality, is a highly bureaucratic organisation with that bureaucracy duplicated through its Alliance contracting arrangements and the business from an operational efficiency viewpoint worse in the East than the West. We have replicated the lean geographically based management structures of South West and Wales, with the same policies, IT and terms and conditions within 9 months. This has led to a reduction in Alliance and directly employed staff of 30% and a reduction in controllable costs of 30% or £108m/year so far. 90% of these savings are efficiency and not synergy savings.

Recent examination of turnkey capital projects show costs in excess of 35% greater than managing the activity in house, and examples of this have been sent to Ofgem. Any argument that tries to explain that the saving of 35% of excess costs by managing in house is paralleled by extra indirect costs incurred by the DNO is destroyed by the fact that indirect costs have been significantly reduced at the same time as managing projects in house. It should be noted that these capital savings are

additional to the cost savings in the previous paragraph and are difficult to quantify but will be available for the RIIO base year. Also we have not identified any network differences that would justify unit costs that differ from South West and Wales, a myth promulgated by the inefficient.

Performance has improved dramatically with CMLs reduced to 45% below the Ofgem targets and CIs 25%. Call centre performance is upper quartile, complaints resolution improved, numbers of customers left off more than 18 hours reduced from 9,463 in 2010/11 to 366, in fact every area has seen massive improvement.

The CN acquisition and before it, the Hyder acquisition provides solid defensible data that demonstrates wide variations in cost efficiencies not revealed by over complex regression methodology and this has resulted in customers paying for inefficiency. These wide variations of efficiency also invalidate high level regressions of Totex since for these analyses to be valid companies must have efficiencies of the same order and this is not the case since there is a wide gap in efficiency between CN as it was and as it is now. It should be remembered that these efficiency and performance improvements are set against the fact that at DPCR5 CN was a middle ranking company and our own analysis shows this to be the case therefore other companies must be even more inefficient further undermining high level regression.

We urge Ofgem to use the detail they have collected and move to a unit cost plus cost driver approach for opex together with unit cost comparison for capex. WPD is a company who has a strong record of delivery and **has taken the commercial risk of backing its judgment that it could vastly improve efficiency using its analysis of cost and its drivers** and the result bears out that analysis.

WPD is happy to share its data and analysis with Ofgem and destroy the DPCR5 myths of urbanity, sparsity, Alliance contracting, labour adjustments, outsourced logistics, perceived tough reliability targets, high capital unit costs and operating cost efficiency analysis.

The beneficiaries of this will be customers.

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Timetable and outputs

**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.**

Setting out the price control timetable in detail at the beginning of a review, and where possible to bring forward discussions and decisions to the earliest feasible point in the process is a positive step. We have no concerns with the timetable or the process, as far as it is known at this point in time.

We support the principle of providing stronger links between the delivery of well justified outputs and revenues. Ofgem have selected six categories of outputs for RIIO which are very close to our own internal monitors and also align with the areas that customers tell us are important to them. In general terms outputs measures should exhibit the following characteristics:

- Controllable
- Measurable
- Comparable between networks
- Auditable

The approach taken by Ofgem to date, building on the approaches from DPCR5 and using the principles established and consulted on as part of RIIO is sensible. In most areas Ofgem has developed measures in conjunction with the DNOs to ensure they are appropriate and meet the above criteria. WPD is supportive of all the output measures in use at this time with the following exceptions:

- Outputs in relation to connection need reviewing as the current Guaranteed Standards are extremely complicated and biased towards the time to deliver a connections quotation with little evidence to date that this provides the required level of service for a customer. A simplification of the current Guaranteed Standards together with a new output that focuses on the overall "time to connection" would be more appropriate and deliver better customer service.
- The losses output measure is flawed as it is not controllable by the DNO.

Ofgem have identified two areas where additional work is needed to develop common industry output measures namely safety and social obligations

Safety

The two primary measures we use within WPD are lost-time and non-lost time accidents involving our employees and contractors. All monthly KPI performance reporting in WPD will contain these measures. WPD believes these indicators should be included in any output report on safety performance but as this is an area where primary responsibilities rest with the company and the HSE, rather than Ofgem we agree with Ofgem's stated proposed approach of not imposing further incentives relating to safety.

Social obligations

The DPCR5 package does not contain any specific outputs in relation to social obligations and it is difficult to identify potential new measures. There are organisations that are better placed than ourselves to help develop some of the options and we would be happy to explore our role through the Ofgem working group and also within future partnership arrangements.

In terms of reporting company performance against outputs, we note that output delivery under RIIO ED1 will be assessed on a balanced scorecard approach using a traffic lights system. The Electricity Distribution Performance Report published by Ofgem provides a good overview of DNO outputs and we support its continued publication.

Under RIIO price controls the onus should be on the network companies to determine how best to deliver outputs over time. We will include our view of outputs within our well justified business plan.

Length of price control

**Do you think ED1 price control period should last for eight or nine years?**

We do not see any material difference between a price control lasting either eight years or nine years. We would accept a nine year price control review.

Regardless of the duration of RIIO-ED1, the mid-period review of output requirements must be clearly specified to avoid it becoming something close to a full-scale review.

Business plans and proportionate treatment

**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.**

As part of the RIIO-ED1 process we will be submitting our well justified business plan to Ofgem in May 2013 which will have regard to stakeholder views and incorporate our plans to deliver value for money outputs and investments to current and future consumers.

We have reviewed the business plans for both the gas and transmission businesses against the Ofgem guidance and looked at the feedback provided on these plans by Ofgem and stakeholders. The key themes that emerge from this exercise are;

- The business plans are extremely large and onerous to read and comprehend, whilst the format and differing terminology makes comparisons difficult. In this respect it would be helpful if Ofgem could give more guidance on the structure and form of the business plan.
- Early visibility of the cost templates and financial model required in support of the well justified business plan is important.
- Ofgem should provide further clarity on attitude to competition between companies over what they include in their business plans versus working collectively/sharing.
- More clarity is needed about Ofgem's proposals for handling uncertainty in business plans and particularly in relation to the treatment of low carbon investment in the cost assessment process.
- The plans are not published early enough in the process for stakeholders to provide an informed view.
- The published business plans are considerable in size and limited in figures, one GDN only provides average figures over the 8 years and many others present data in graphic form when tables of numbers would have been more useful.

We are generally supportive of the proposals to utilise a proportionate approach. The principle is reasonable and could reduce some unnecessary administration. We are supportive of the fast track process and we intend to demonstrate the characteristics of a fast track company. The criteria for participation in the fast-track price review as set out in gas and transmission are sensible but it is still unclear how the process will work or what the benefit is to a fast-tracked company.

Enhanced stakeholder engagement

**We welcome feedback on the company stakeholder engagement processes used in RIIO-T1 and GD1 and also welcome feedback on the consultation being initiated by the DNOs.**

WPD strongly support the involvement of customers and other stakeholders in the price review process. We have recently published details of how stakeholders can get involved in RIIO-ED1 and details of associated stakeholder engagement to date are on our web-site.

As part of our stakeholder programme, we have over the last four years, held a series of workshops across South West and South Wales. We used these workshops to seek views on the discretionary items of expenditure in our DPCR5 business plan, inform stakeholders on the final outcome of the DPCR5 review and then to update them on our progress against the final plan and the targets agreed with Ofgem. The outcomes from these workshops drive specific customer initiatives, set the themes for discussion with our own Customer Panel and inform our wider research.

More recently, workshops have been specifically aimed at encouraging involvement in the development of our future business plans and identifying stakeholder priorities and required outputs. This on-going dialogue provides us with a good base of knowledge to understand customer expectations and is one of the mechanism's we will use to will inform the development of our well-justified business plan.

We have recently introduced this approach into WPD Midlands and during February 2012 we completed a series of workshops across the region. In addition to introducing ourselves as the new owners of the Midlands network, we discussed what our focus areas and priorities for investment should be in the RIIO-ED1 period under the headlines 'customer service and network improvement' and 'innovation and environment'.

Initial indications from our 2012 stakeholder events are:

- Awareness of WPD and the role of a distributor could be improved.
- WPD's primary purpose must be to continue to provide a reliable supply and keep the lights on.
- There is limited support for further reductions in power cuts or dips.
- Improving service for new connections (both demand and generation) remains an important issue.
- There is an increasing emphasis on the provision of information across a range of areas including emergency planning, regional development and for more information to be provided to potential DG connectees.
- Emergency planning is increasing in importance.
- There is general support for anything networks can do to facilitate carbon reduction with particular support for trialling technology.
- Future-proofing asset replacement should be a significant area for focus in long term planning.
- Innovation and developing new technologies/monitoring equipment to make better use of the existing network are also ranked as important.
- WPD should not proactively invest in electric vehicle infrastructure

- Suppliers want to know how their charges will be affected by RIIO-ED1

WPD have reviewed the stakeholder engagement processes followed by both the transmission and gas companies and will incorporate areas of best practice into its own approach to RIIO-ED1. We would also like to participate in the Ofgem led “Price Control Review Forum” (PCRF). It would be helpful for our stakeholder process if Ofgem made the feedback that it receives from stakeholders more readily available to networks.

The real test of whether the greater emphasis on stakeholder engagement has been a success or not will be in how the DNOs incorporate stakeholder views and feedback into their business plans and the outputs they wish to deliver.

**We invite any parties with an interest in being involved in the PCRf or any of the working groups to contact us by 27<sup>th</sup> February 2012 and explain what they believe they could contribute.**

WPD is already a key contributor to many of the industry workgroups and our aim is to play a full role in developing an outputs led framework with appropriate incentives to deliver long term value for money services for stakeholders.

WPD have submitted its nominations for each of the working groups and have already participated in the Flexibility and Capacity and Outputs working groups.