Response to Ofgem strategy consultation for RIIO-ED1 price control

November 2012

Consumer Focus
Campaigning for a fair deal

About Consumer Focus

Consumer Focus is the statutory consumer champion for England, Wales, Scotland and (for postal consumers) Northern Ireland.

We operate across the whole of the economy, persuading businesses, public services and policy-makers to put consumers at the heart of what they do.

Consumer Focus tackles the issues that matter to consumers, and aims to give people a stronger voice. We don't just draw attention to problems – we work with consumers and with a range of organisations to champion creative solutions that make a difference to consumers' lives.

Following the Government's consumer advocacy reforms, we will continue to act in the consumer interest across a wide range of sectors until our general advocacy role passes to the Citizens Advice service in April 2013.

As part of the reforms, Consumer Focus will establish a new unit to identify and represent consumers' interests in complex, regulated sectors, including energy and postal issues and, in Scotland, water.

Our Annual Plan for 2012/13 is available online, **consumerfocus.org.uk**

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General commentary

We are unable to respond in detail to all of the consultation questions for all of the annexes. Instead we have provided responses to all relevant questions within the strategy document.

We feel the most important element for consumers is the ability of ED1 to deliver reliable, low carbon networks at lowest cost to consumers. We are reassured by early drafts of certain Distribution Network Operator (DNO) stakeholder documents that a spike in network charges for the ED1 period is not anticipated, although have not seen proposals from all of the DNOs.

Broad Measure of Customer Satisfaction (BMCS)

We do not feel a fixed target for the BMCS is appropriate and prefer Ofgem's proposal to use rolling targets based on the average level of performance across DNOs. We feel that due to the relative youth of the BMCS, it will be difficult for Ofgem to determine the optimum level for a fixed target. As Ofgem's understanding of the BMCS increases, it may be appropriate to consider moving to a fixed target.

Improved reporting

ED1 and future price controls herald a more proactive role for DNOs and may result in higher network charges for consumers. Existing reporting requirements on DNOs tend to produce technical and relatively inaccessible documents. DNOs and Ofgem should consider more accessible ways for reporting DNOs' performance. This will increase transparency and help build trust and confidence between DNOs and consumers.

Network losses

Reducing distribution network **losses** is important for consumers who must pay for more energy generation to make up for losses and suffer the environmental damage for this 'extra' generation. While some losses are inevitable, it is vital that DNOs are effectively incentivised to reduce them. The proposed losses reduction mechanism is likely to result in improved losses reduction activity compared to the DPCR5 period. However, we are concerned the three-layered approach risks being overly complex.

We feel there should be a national approach taken to reducing losses, where investment projects compete on a national basis for a finite pot of losses allowance. This is because, in terms of carbon emissions, it does not matter where losses reduction takes place: the main focus should be on ensuring the limited resources available to reduce losses are targeted at those investments that will deliver the greatest impact.

Projects would only be considered when supported by robust historical load data. There may be some lag in investment decisions while this data is collected, which seems consistent with the objective (5.22) to improve the data quality for decision making. As an incentive to reduce losses, DNOs would receive an ex ante reward based on proportion of the projected lifetime savings (both carbon and financial) that result from the losses reduction measures. There should also be a 'truing up' mechanism to encourage DNOs to submit accurate assessments of likely losses reductions.

We feel this approach will lead to a more targeted use of scarce resource and should help deliver the best value for money for consumers.

Guaranteed Standards (GS)

We support the proposal to reduce the supply interruption period from 18 to 12 hours for consumers' entitlement to a fixed payment from their DNO ('Outputs, incentives and innovation', 3.18) and the index linking of GS payments. However we note that consumers must still actively claim for payments under GS2. Because of low awareness of the GSs among consumers, this is a barrier to full uptake of compensation payments. This both denies consumers compensation for inconvenience experienced when standards are not met and reduces the financial incentive on DNOs to avoid GS breaches.

We believe it is in consumers' interest that DNOs move towards a system of automatic payment to consumers. Consumers on Priority Service Register should be eligible for automatic payments as a matter of urgency.

Strategy consultation question responses

CHAPTER: Three

Question1: Do you have any comments on our stakeholder engagement approach?

The RIIO ED1 consultation is a voluminous and expansive document, replete with multiple annexes and requiring considerable resource to respond to. We are concerned this means only those organisations that are directly and materially impacted by ED1 - and who have the necessary resources - will be able to respond in a comprehensive way. We have certainly heard anecdotal evidence to support this. While we hope these stakeholders will engage with the DNOs' own stakeholder engagement process, their level of influence may be diminished as many of the strategic policy decisions have already been taken.

We note from Appendix 5 that the intention appears to be for all 14 DNOs to consult on their business plans simultaneously and for this consultation to only last for four weeks. During RIIO-T1 we found it impossible to respond to the business plan consultation round due to the sheer scale of documentation issued (eg those of the three electricity Transmission Owners (TOs) alone totalled approximately 1,800 pages). If you want meaningful stakeholder engagement with the business plan consultation, we think that you should consider revisiting your approach in this area.

Question 2: Do you have any views on how our engagement process or that of the DNOs could be made more effective?

It is too early to say how effective our engagement with DNOs has been. We have only been able to attend a stakeholder event organised by UKPN. This was conducted in an open and professional way, but we cannot comment on its effectiveness as this can only be measured by its impact on the Business Plan and ultimately the consumer experience.

Our view is that the Ofgem process was too DNO focused. While some attempt was made during the RIIO ED1 working group meetings to bring non DNO representatives up to speed, there was an implicit assumed level of background knowledge for subjects that are often very technical. This can make it more difficult for non DNOs to engage effectively in the process. One of the ways this manifested itself was the drop off of non DNO representatives as the process continued. This represents a missed opportunity to capture the views of stakeholders.

One possible remedy might be to offer technical 'teach ins' for non DNO stakeholders to improve their base level of understanding. It is hard to say what uptake there might be and these are likely to be quite resource intensive, although could be delivered by a third party to limit the resource implications.

There also appears to have been a slight disconnect between the early 'hype' surrounding RIIO and the reality. RIIO was presented as somewhat of a revolution in Ofgem's approach to price controls. Our opinion is that was has emerged represents more an evolution from the current DPCR5 price control than a revolution.

CHAPTER: Four

Question1: Do you have comments on the form or structure of the price control?

Figure 4.1 provides a helpful oversight of the process, although it lacks key details that would improve our understanding. In particular, it would be helpful if estimates of the materiality for the price control building blocks were included so we might better understand what 'blocks' have the greatest impact on consumers' bills and on DNOs revenue.

Ofgem's Electricity Distribution Annual Report is a comprehensive summary of DNOs' performance. However, its length may limit its accessibility. We feel there may be merit in producing an enhanced executive summary or a supplementary document that seeks to present in a more concise and accessible way the financial information contained in the Annual Report. It would be helpful too if it could be more explicitly linked with Figure 4.1 in the consultation document.

It is predicted by many that the role of DNOs will change as they take on the role of Distribution Service Operator. Such a role may require additional revenues and increase the impact and visibility of DNOs' activities on consumers' lives. A timely move towards increased visibility on performance and cost will help to create trust between consumers and DNOs.

Question 2: Do you agree with our proposed changes to the RIIO-ED1 timetable?

We recognise that RIIO's intention in setting longer term price controls is to encourage the networks to think more strategically. We retain some anxiety that the scale of investment, and pace of technological innovation, that the networks currently face may mean that forecasts or investments made in good faith turn out to be materially wrong. A pre-condition of our support for eight year price controls is therefore the existence of very robust uncertainty mechanisms to protect consumers, and a credible process for mid-term review should initial assumptions prove to be wrong.

From a stakeholder perspective we can see some value in having different start dates for the Gas Distribution, Electricity and Gas Transmission and ED1 price controls. Staggered start dates are likely to make the consultation process less brutal for your stakeholders. They could allow for lessons from success/failure in one scheme to be applied more widely, more quickly.

Question 3: Do you have a view on the materiality of potential changes in allowed revenues/charges between price controls? Do you have proposals to address this?

We do share the concern voiced by suppliers over the impact of volatility in distribution charges which is likely to increase their risk premia, a cost ultimately borne by consumers.

However, we are also concerned not just by the volatility but the level of the changes between price controls. A rapid jump in Distribution [Network] Use of System charges will cause an unwelcome spike in consumers' bills. We fully support measures to smooth the impact of increases on consumer bills – perhaps over multiple price controls if the materiality is high. For consumers, forward visibility on price increases is less important than the minimisation of any increases and the avoidance of spikes.

We would support further research into increasing the intergenerational equity of network investment. It does not seem entirely equitable for today's consumers to pay the full cost of network investment in assets that have a 45 year life. Our opinion is that greater innovation in the financing of network investment will help to spread the burden across both current and future consumers.

CHAPTER: Five

Question1: Do you consider that the proposed outputs and associated incentive mechanisms, taken together with other elements of the price control, will ensure that companies deliver value for money for consumers, and play their role in delivering a sustainable energy sector?

An output-based approach does seem a sensible framework in which to deliver consumer benefits. However, the level of incentives is perhaps the single biggest influencer on DNO investment decision. DNOs will 'trade off' those incentives and outputs dependent on their risk and potential reward. Without more information on the potential materiality of the incentive mechanism it is hard to judge their effectiveness at delivering objectives, particularly where a potential conflict between objectives exists. There appears to be some merit in a table (approximately) ranking the numerous incentives/penalties that will apply to DNOs during ED1 so stakeholders may better understand DNOs likely behaviours.

Question 2: Do you consider that the proposed outputs and incentive arrangements are proportionate (eg do we have too many or too few)?

No comment.

Question 3: Do you have any views on the proposed outputs and incentives?

Network charges

We are concerned the proposed outputs may result in a sharp increase in network charges for today's consumers. We do not feel there is sufficient emphasis on how innovation could *reduce* the need for reinforcement. For example, it remains unclear how robust the analysis of alternatives to those options offered by DNOs in their business plans will be. Alternatives that do not appear in DNO business plans, but may offer better value for the consumer, may not therefore receive due consideration. This may lead to higher cost solutions than may otherwise have been the case.

We are also concerned by the opportunity provided by paragraph 5.14 for companies to be able to 'set out alternative or additional output measures within their business plan'. We understand this is intended to add flexibility to DNOs to add innovative solutions. However, we are concerned that output measures added by DNOs in their business plans may not be subject to the same level of scrutiny by stakeholders as the output measures Ofgem is currently consulting on. Stakeholders for DNOs business plans will inevitably be less broad in their makeup than Ofgem's consultation, notwithstanding our earlier comments on the limitations of Ofgem's ED1 consultation process. Where an additional output is put forward by a specific DNO – in particular one with a high materiality – we feel that this should be subject to robust scrutiny, or separate consultation.

It seems likely that DNOs' allowed revenues for ED1 will increase at a rate above inflation. This will compound the effect of the proposed 50 per cent increase in possible incentives for DNOs under the BMCS and is likely to exacerbate fuel poverty and adversely impact vulnerable consumers.

Broad measure of customer satisfaction

We note the proposal to increase by 50 per cent the proportion of allowed revenues that DNOs may receive under the BMCS. Our recent visits to DNOs suggest the BMCS is helping to deliver improved customer service, for example through increased call centre staffing levels, upgrades to IT and telephony systems, and improved business processes. Perhaps one criticism would be that this areas has been somewhat neglected before.

The BMCS is in the order of several millions pounds per annum per DNO over the course of the price control. However, we are not clear if the BMCS represents good value for money for consumers given the relatively modest cost of some of the changes it has encouraged. We would hope this will be reviewed to assess the value for money provided by the BMCS.

We support Ofgem's proposal to review the scope of the BMCS survey to include other ways of consumer interaction with DNOs. However, the current method Ofgem uses to appraise DNOs' performance for telephone based contact is unlikely to be suitable for social media. Rather than trying to apply existing measurements for telephony to new media, we would suggest your approach should be reversed ie you should assess what metrics can be successfully measured in new media and then develop appropriate incentives to match. While telephone service will remain an important route for consumers to contact their DNO for some time, other channels are likely to increase in importance over time.

Improved performance reporting

We support the current 'traffic light' system for companies' performance as it is easy to understand. However, its inclusion within the Annual Report is likely to mean its audience will exclude the majority of consumers and remain the preserve of industry and energy specialists. We suggest that an obligation on DNOs to prominently display their performance indicators to their customers should be introduced. The absence of a clear and accessible indication of their DNO's performance will reduce consumers' ability to engage meaningfully with the stakeholder engagement that is a cornerstone of the RIIO process. This will become more important in the light of possible network charge increases and the more consumer-facing role that some stakeholders believe DNOs will have.

Given low consumer awareness of DNOs, we feel the proposal for DNOs to publish their business carbon footprint (BCF) as a 'reputational incentive' (5.29) is very weak and highly contingent on Ofgem's proposal to publish the actions DNOs have undertaken to reduce their BCF. It is unclear who the audience for this publication would be and even less clear how effectively this will motivate DNOs to reduce their adverse environmental impact.

Network losses

Reducing distribution network losses is important for consumers who must pay for more energy generation to make up for losses and suffer the environmental damage for this 'extra' generation. While some losses are inevitable, it is vital DNOs are effectively incentivised to reduce losses. For the DPCR5 period there has been no effective incentive on DNOs to reduce losses.

The ‘duties-based approach’ (5.15, Outputs, incentive and innovation) in ED1 would place a licence obligation on DNOs to limit losses. We share Ofgem’s concern that this is likely to be a weak motivator for losses reductions. A licence obligation to reduce losses without specific targets is likely to be almost impossible to enforce. Without an effective sanction, it is unlikely such a new obligation will have much impact.

We feel there should be a national approach taken to reducing losses, where investment projects compete on a national basis for a finite pot of losses allowance. This is because, in terms of carbon emissions, it does not matter where losses reduction takes place: the main focus should be on ensuring the limited resources available to reduce losses are targeted at those investments that will deliver the greatest impact.

Projects would only be considered when supported by robust historical load data. There may be some lag in investment decisions while this data is collected, which seems consistent with the objective (5.22) to improve the data quality for decision making. As an incentive to reduce losses DNOs would receive an ex ante reward based on proportion of the projected lifetime savings (both carbon and financial) that result from the losses reduction measures. There should also be a ‘truing up’ mechanism to encourage DNOs to submit accurate assessments of likely losses reductions.

We note your proposal to review the losses mechanism in ED2 (5.28). ED2 will commence in 2023 and we feel that 11 years is too long to wait for a more robust losses mechanism. Unnecessary delay will result in avoidable costs for consumers. The mass roll-out of smart meters commences in 2014 and is due to be completed in 2019. It therefore seems likely that there will be significant body of data during the mass roll-out period that could be used to drive forward losses reduction initiatives. The benefits to losses reduction from smart metering do not require the total roll-out of smart meters. Indeed the total roll-out of smart meters is unlikely to ever occur, given that some consumers are likely to choose not to have smart meters installed. We therefore do not agree with the proposed delay in reviewing the losses mechanism until ED2 starts in 2023, given the continuing financial and environmental cost to consumers this will cause.

We feel Ofgem should be bolder in embracing the early opportunities the smart metering programme will bring and should not focus on the ‘unknown problems with meter readings’ (5.25) resulting from the smart meter roll-out, but rather fully embrace the new opportunities provided by smarter metering and encourage DNOs to do the same.

The proposal to establish a £32 million discretionary reward for efficient and innovative loss reduction initiatives (5.27) , assessed by a panel of experts, is likely to have limited impact in terms of overall losses reduction as it only represents about £285,000 per annum for each of the 14 DNOs for the price control period. However, in combination with the duties and losses allowance approach, it should lead to an improvement in losses reduction activity from the current (low) position.

Connections

We support the move to distinguish between large and small customers, but feel there may be reasons for additional positive discrimination for community-led distributed generation compared to commercial connections. We accept there may be some difficulties in achieving an acceptable definition that clearly distinguishes between them. Community-led projects can enjoy broader community support than commercial connections. Extra support to such projects may provide opportunities to avoid reinforcement costs in areas where commercial projects find it difficult to gain community acceptance.

We welcome the proposal to provide more upfront information to customers (5.36) on load information. This will become even more important as we transition to electric cars and heat pumps and more distributed generation. This information is widely held by DNOs, particularly at higher voltages, and should be made more easily available to consumers and generators. This will enable more efficient exploitation of the existing network capacity.

We support Ofgem's intention to improve competition in connections as this could deliver more choice for consumers and drive down connection costs. However, at this stage we are not sure how successful the competition test will be in determining if competition that benefits consumers exists. The competition test is a 'one off' event triggered by a DNO – once a DNO is successful in convincing Ofgem that competition exists, there is no subsequent test or review and the DNO may then charge unregulated margins on connections. Notwithstanding the possible limitations of the test's effectiveness at judging the existence of competition, while competition may exist at the time of the test, there is no guarantee that a competitive market will continue post test. If subsequent concerns over the effectiveness of competition were then raised, the principal sanction Ofgem would have post test would be a referral to the Competition Commission (CC). A CC referral is an onerous and resource intensive process and is only likely to be undertaken in cases of the most blatant anti-competitive practices. This leaves a potential 'detriment gap' between possible consumer detriment and the threshold for a CC referral.

Guaranteed Standards

We support the proposal to reduce the supply interruption period from 18 to 12 hours for consumers' entitlement to a fixed payment from their DNO ('Outputs, incentives and innovation', 3.18). However, we note that consumers must still actively claim for payments under GS2. This is made difficult because most do not know their DNO exists and DNOs do not, in general, proactively market GS information. This both denies consumers compensation for inconvenience experienced when standards are not met and reduces the financial incentive on DNOs to avoid GS breaches.

It is impossible to be certain that all consumers who have experienced service levels that fall short of the Guaranteed Standards have received appropriate compensation. Evidence we have gathered and shared with Ofgem and DNOs shows there is a low level of consumer awareness of their DNO and there may be a failure by consumers to claim for compensation payments to which they are eligible. Our evidence is based on telephone interviews with consumers; data from Consumer Direct (CD); and GS data returns by DNOs.

Our omnibus telephone based research showed that on average 13.8 per cent of consumers do not know who their DNO is and when consumers suffer a power cut, 71 per cent would call their supplier. How can a consumer make a claim for a compensation payment under the GSs when most do not know who their DNO is?

The results of a Consumer Focus Statutory Information Request (SIR) to DNOs shows that DNOs do not proactively market information about the GSs to their customers, although some DNOs do send out GS information at certain customer contact points, for example when a new connection is being provided. Consumer Focus has sought to raise consumer awareness of consumers' right to compensation under the GSs through the promotion of the **Consumer Checklist** but DNOs and suppliers could do more to promote and communicate the GSs to their customers.

In our omnibus survey, 22 per cent of people reported that they had not received notice for a planned interruption, in contravention of GS4. This suggests there may be more DNOs can do to improve their communication on planned outages to their customers.

A card addressed 'to the occupier' may no longer be fit for purpose, and other communication channels should be explored and encouraged that better meet the modern consumers' expectations.

Very few GS payments are logged under GS5, investigation of voltage complaints, but CD received on average 11 calls every month about quality of service issues. This is a relatively high number compared to the total number of calls to CD. The increased deployment of renewable generating technologies is likely to increase the challenge of maintaining the quality of consumers' supplies, so it is important there are robust mechanisms in place to compensate consumers when service levels drop. At present there is some doubt that GS5 provides adequate reassurance.

We welcome the proposal to consider the introduction of penalties on DNOs for failing to make GS compensation payments. However, we feel this proposal does not go far enough. Automatic payments to consumers who experience service levels that fall short of the GSs should be mandated. Some suppliers are already making payments to consumers under the Failure to Supply Gas GS based on data supplied to Xoserve by gas network operators. This may provide a model for a sensible and low cost route to increase GS payments to eligible consumers and overcomes the impasse of DNOs only knowing the MPAN and not the customers' contact details.

We support the proposal to remove the Highlands and Islands (H&I) exemption from specific guaranteed standards (3.18), subject to an assessment of its materiality. A change in H&Is' consumers treatment seem timely given that DNOs should now be able to adopt more innovative solutions to prevent GS breaches than had been the case under RPI-x.

We also support the proposal to remove the DNO exemption from paying out in the event of a one-off exceptional event. While such events are deemed outside the DNOs' control, consumers have experienced inconvenience so it is appropriate they are compensated.

We support the index linking of GS payments at the end of DPCR5. If payments are not index linked, this represents an effective annual reduction in their real value to consumers. In contrast it should be noted that DNOs allowed revenues are inflation adjusted. It would seem almost perverse that DNOs are protected from the impact of inflation, while poorly served consumers – some of whom may be in vulnerable situations – are not.

We welcome the proposal to explore whether payments to customers on the Priority Services Register (PSR) should be made automatically. However, we do not feel this goes far enough. If a customer is on the PSR then a DNO has all the details it needs to make a payment to an affected consumer. We do not see a good reason, why this is not implemented in the short term, as an interim measure before automatic GS payment to all eligible consumers is introduced. The longer the delay, the more consumers in vulnerable situations will continue to be left out of pocket for sub standard service from their DNO.

Socialisation proposal for connections

In the pre smart world, we cautiously support the proposal in 3.43 of the outputs, incentives and innovation annex for a socialised approach. Again we would hope that even before the end of the mass roll-out phase of the smart metering programme, there may be sufficient data to move to a more cost reflective model. We think there may be some merit in considering a 'fixed fee' for connections. This would represent something of a 'half way house' between socialisation and full cost reflectivity. It would provide a signal to network users who were placing a higher demand on the network, while not acting as a significant barrier to connections.

Other tools to manage uncertainty

3.22 and 3.23 of the outputs, incentives and innovation annex refer to the importance of effective consideration of strategic investment. We would welcome further clarity on what approach Ofgem will take to make such a determination

CHAPTER: Six

Question 1: Is our proposed approach to cost assessment appropriate?

No comment.

Question 2: Do you have views on our proposed use of proportionate treatment?

We do have some concerns over the ability to judge a high quality business plan at the beginning of the RIIO process ie ex ante. The RIIO approach is a step change from RPI–x for DNOs. To this extent we feel that historical data will be less useful than under previous price controls, reducing the reliability of the evidence base on which Ofgem will base its judgements.

We would also like to better understand paragraph 6.14, in particular how Ofgem will ensure a fast tracked DNO does not secure a settlement that means they were worse off than had they remained in the process, while ensuring that consumers exposure to the risk of additional costs is not increased.

Question 3: Do you have any views on the criteria for assessing business plans?

We note in 6.16 that you are working with DNOs to develop proposals for totex and disaggregated modelling. We would welcome further information on how these proposals will be stress tested. For example would stress testing be undertaken by an independent accounting firm or in house? We would hope Ofgem would conduct an assessment of international approaches as part of this exercise in case they offer useful learning opportunities for practices in the UK.

CHAPTER: Seven

Question 1: Do you have any views on the role of innovation in RIIO-EDI?

DNOs are likely to face choices on whether to make an early investment decision in anticipation of need, or to delay investment until there is a firm requirement. Network investment in the ED1 period is likely to exacerbate the likelihood of DECC's predictions that consumers will face significant increases in bills until the 2020s. We would like to see greater innovation in the mechanism available to DNOs to finance early investment, where it is in consumers' long-term interests. Effectively we would like to see additional options for spreading the cost of network investment across multiple price control periods to reduce the short term impact on consumers' bills while enabling timely network investment. The 'logging-up' uncertainty mechanism may provide a route for achieving this.

Question 2: What should the funding threshold for the NIC be? Do you agree with our proposal to review it after two years to reflect learning from the LCN Fund?

The Network Innovation Competition (NIC), the Network Innovation Allowance (NIA) and the Innovation Roll-out mechanism (IRM) provide funding for DNOs to innovate and roll-out their innovation. There appears to be the potential for considerable overlap between these revenue sources resulting in an effective overpayment for innovation and poor value for money for consumers.

We have heard anecdotal accounts that the current Innovation Funding Incentive represents poor value for money (VFM) for consumers. We have been unable to objectively assess this claim. However, we would suggest proportionate and targeted sampling and investigation should be employed to assess whether the IFI provides VFM for consumers.

It is unclear what verification will form part of the NIA. Given the high materiality (between 0.5 to 1 per cent of allowed revenue) we would strongly support robust, but proportionate, verification of how the allowance has been spent. We would like to see concise published reports demonstrating what has been delivered for consumers and what level of verification this investment has been subject to.

We would hope the IRM will lead to the development of an 'innovation index' – a ratio of the environmental benefit to costs – during the course for the ED1 period. This should aid benchmarking and prioritisation of future investment decision. We would hope that this would be reported in a transparent manner and does seem to lend itself to inclusion within the traffic light system as part of the annual report.

CHAPTER: Eight

Question 1: Do you have any views on the uncertainty mechanisms identified?

The future is always uncertain, but rarely more so than at present. The energy sector faces significant upheaval as a result of challenging carbon targets, ageing infrastructure and policy uncertainty. Technologies like electric vehicles and heat pumps, and consumer products such as Time of Use tariffs or 'smart' goods, could have a profound effect on distribution networks – but the timing and scale of these impacts remains very uncertain. It is therefore absolutely vital for consumers that ED-1 contains robust uncertainty mechanisms that protect them from the (likely) risk that forecasts and planning assumptions made entirely in good faith turn out to be materially too optimistic or pessimistic.

Paragraph 8.16 suggests that policy development deemed necessary under the mid-period review will be a bilateral between Ofgem and DNOs. Given the intention (in 8.13) to 'meet the needs of consumers and other network users' it would seem helpful if a multilateral approach to stakeholder consultation is taken. While we note the current proposal for a three month consultation (following the early bilateral discussions), at this stage many of the key ideas will, in practice, be 'fixed', leaving limited opportunity for significant policy changes resulting from the input of other stakeholders.

We are concerned there will only be a qualitative materiality test to decide whether a material change in the mid period review of outputs is required (8.13). We feel this will not always be the case and quantitative data should be used when available.

A stronger evidence base for increasing costs to consumers is required otherwise there is an asymmetry of risk: increases in network charges will definitely result in consumer detriment (through increased bills) whereas the absence of a robust materiality test for output adjustments means there is a greater risk the intended consumer benefit does not materialise or brings less benefit than originally intended.

Question 2: Are there any additional uncertainty mechanisms required?

No comment.

Question 3: Are there any mechanisms that we have included that are not necessary and why?

There may be a case for introducing a specific output for reducing distribution losses given their high material and environmental costs to consumers. Since there will have been no effective incentive on DNOs to reduce their losses for the entire DPCR5 period, this is a strong reason for a robust measure that results in tangible losses as soon as possible.

Please see our answer to question 3 for more details.

CHAPTER: Nine

Question 1: Do you consider that our proposed package of financial measures will enable required network expenditure to be effectively financed?

No comment.

Question 2: Do you have any views on our proposed approach to assessing the cost of equity and the associated range of 6.0-7.2 per cent (real post-tax)?

No comment.

Question 3: Do you have any views on the other elements of our financeability proposals?

No comment.

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Published: November 2012

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