

Hannah Nixon
Office of Gas and Electricity Markets
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23 November 2012

Dear Hannah

Response to Strategy Consultation

At Electricity North West we welcome Ofgem's strategy consultation. The document is well researched, the ideas well developed and the logic is well written. The Ofgem team has engaged with a wide range of stakeholders across a wide range of working groups, taking views and developing ideas in an open, transparent and effective manner. The result is a consultation with mature ideas and proposals. Having proposals and options that are well developed at this stage enables clear and distinctive opinion to be expressed by stakeholders in response to the consultation.

As would be expected, we have considered and detailed views to express on all of the issues raised in the suite of documents and these have been set out in a full and comprehensive manner in the enclosed response. There is a key issue that unites our views across the entire scope of the response. Having developed all the constituent elements of the price control package to this level, the time is now right to step back from the detail and consider how these elements combine to create an acceptable package. We understand that the Ofgem team also recognises this need and that the mechanisms to do so are being developed. An overview of outputs, incentives and uncertainty mechanisms will be undertaken through one of the continuing working groups and analysis tools to calibrate incentives on a common basis are being developed. This is an essential next step and we have committed our support to the development of these tools. It will also be necessary to establish a forum that can marry such views on outputs, incentives and uncertainty mechanisms within a wider consideration of the form and structure of the price control package, affordability for customers and the financial measures proposed.

When we take a holistic view of the price control package we see that there is a need for some key decisions at the more detailed level. Overall the price control package of elements has become unbalanced and corrective action is required. There are a number of areas where it is proposed that DNOs take on more risks to protect customers; this is a worthy intent. There are also a number of changes required to implement the RIIO principles that will lead to a more stable and predictable regime, which is also an appropriate aim. However, implementation of all these changes as currently proposed leads to a reduction in the potential incentives to deliver what customers most value. When this is combined with the increased perception of risk it is likely to drive away essential investors or drive up the overall cost of equity that customers must bear.

We are developing a robust business plan for the RIIO-ED1 period that focuses on the requirements of our customers and stakeholders in the North West. At a macro level, these requirements are very strongly aligned with the requirements of national stakeholders. In developing this plan we see a number of areas where some of the changes proposed in the strategy document may limit our ability to deliver on all of this plan. Limiting change and preserving more of the strengths of the current price control package will enable full delivery for customers and redress the imbalance we currently observe in the overall package. This imbalance can be addressed by a small number of key changes:

- Powerful incentives on DNOs to deliver what customers require must be maintained.
- Maintain funding for developing transition to the low carbon future
- Transitional measures to enable the effective implementation of the RIIO financial principles should be deployed.
- DNOs that set the benchmark for the efficiency in the sector should be encouraged and incentivised to bid keenly.

These must be the key areas of focus over the next few months to ensure that the February Strategy decision creates a framework to incentivise the best value bids that DNOs can possibly conceive. My team and I, as ever, remain fully engaged in working with stakeholders, other DNOs and the Ofgem team to address all these issues and identify the appropriate solutions. There is still a lot to do, but we have already achieved more than might have been expected at this point and I am confident that the next phase of work on RIIO-ED1 will be equally fruitful.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'P. Bircham', written in a cursive style.

Paul Bircham
Regulation Director