Ofgem Strategy Consultation for the RIIO-ED1 Electricity Distribution Price Control

Issued 28th September 2012 (Ref 122/12)

SP Energy Networks Response to Annex – Outputs, Incentives and Innovation

23rd November 2012

Please address any queries to: **Jim McOmish**

Head of RIIO-ED1 Programme

SP Energy Networks at

riioed1consultation@spenergynetworks.com

OVERVIEW

We welcome the opportunity to comment on Ofgem's Strategy consultation for RIIO ED1 – Annex Outputs, incentives and innovation – reference 122/12 published on 28th September 2012. The primary outputs, incentives and innovation elements of ED1 are a critical element of the regulatory framework in ensuring a satisfactory outcome for the DNOs, their stakeholders and customers.

QUESTIONS RESPONSE

Table of Contents

1. CHAPTER ONE – INTRODUCTION

No questions posed.

2. CHAPTER TWO – OVERVIEW OF OUTPUTS AND INCENTIVES

We are concerned that the proposed calibration of the Information Quality Incentive (IQI) and Efficiency Incentive Rate (EIR), in combination with the lower scrutiny for fast track companies, results in a clear incentive for companies to adopt an overly aggressive and optimistic approach to their ED1 bid in an effort to obtain additional rewards whilst minimising regulatory scrutiny.

An effective outputs framework should recognise the full range of investments necessary to ensure the integrity of the network during ED1. We do not believe the framework established for DPCR5 achieves this outcome. For example, the current framework does not give recognition for investment in all asset types (e.g. low ground clearances on overhead lines, or investment to replace ageing rising mains and laterals). We would like to see this rectified in the ED1 outputs framework and will continue to engage with Ofgem's ED1 working groups to help inform policy decisions.

We welcome proposals on the further development of the asset health index to include asset criticality. We have provided a detailed response on asset criticality in Annex 7 Reliability & Safety. If developed correctly, this will allow DNOs to apply a risk based re-prioritisation to asset investment, improving network safety for the benefit of the public, our customers and our staff and contractors.

We agree that any revenues associated with undelivered outputs that remain valid should be clawed back with a penalty. This treatment could also apply to any lower quality outputs that have been delivered on a pro rated basis. However, there are circumstances where the correct course of action is to reprioritise activities in order to delay investments, or where outputs are no longer required for valid reasons. In these circumstances it would seem appropriate that the worst case is that a company should lose the revenues that it has already received, but that this clawback might be subject to a reward to encourage companies to make these decisions if appropriate.

Given the proposed strengthening of the Efficiency Retention Incentive, combined with an 8-year price control with annual allowed revenue model iterations, and the uncertainties of the transition to a low carbon economy, we do not believe that DNOs should have to fund the catch-up of undelivered outputs for the period of the next price control.

2.1 ***Question 1:*** *We welcome respondents views on the approach we have taken to develop the outputs framework.*

The primary outputs identified are core to the operation of a DNO business and our business plan will reflect delivery against these. We have taken the opportunity to engage with Ofgem's Policy Working Groups to develop the outputs framework and will continue to participate fully in the ongoing policy development.

We agree that financial rewards and penalties should only be applied where the output is controllable, measurable, auditable and comparable. We also support the retention of existing output measures that are working well in DPCR5 and the development of new measures only where appropriate.

2.2 ***Question 2:*** *Do any of our proposed output measures present potential difficulties in ensuring the submission of accurate and comparable data?*

We identify several areas where the proposed output measures present potential difficulties in ensuring the submission of accurate and comparable data.

Whilst we support the replacement of the DPCR5 losses mechanism with an engineering-based assessment process, we believe there may be difficulties in terms of comparability and consistency across all DNOs. We believe that any mechanism needs to take into account the differences in starting values and engineering solutions for loss reduction across the DNOs and we welcome more clarity on how this measure will reflect this.

While we recognise that the proposals for the measurement of social obligations activities are not yet mature, we believe that translating social obligations outputs into measurable and comparable data will represent significant difficulties due to the qualitative nature of the outputs. We acknowledge that it may be possible to quantify the efforts of DNOs in improving service to customers in terms of fuel poverty, vulnerability and safety, but quantifying the success of these measures and their impact upon these main issues may prove more difficult. Equally, identifying a comparable starting point for DNOs in terms of the delivery of social obligation activities may also prove problematic.

In terms of submitting accurate and comparable data on Average Time to Connect, we welcome clarity on how exceptions outside the control of the DNO (eg. where a customer requests a later connection date, or where wayleaves issues stall the planning process) will be reflected in the measure.

2.3 ***Question 3:*** *Should we use a percentage of allowed revenue or £m set using basis points of return on regulatory equity (RORE) to set caps and collars?*

Our view is £m set using basis points of Return on Regulatory Equity to set caps and collar better facilitates comparison of the materiality of the cap or collar to the licensee and therefore transparency. In addition it ensures that the risk (or risk mitigation) has the same relative impact on financeability for all licensees.

Basis points of RORE should therefore be used to set the risk and in tandem the £ value impact should be explicitly stated.

2.4 ***Question 4:*** *Are there any aspects of our proposed outputs framework where the reporting requirements are likely to lead to disproportionate regulatory costs?*

For the measures that are currently well defined we do not believe that the proposals will lead to disproportionate regulatory costs as in most cases they are an extension of an existing measure eg Health Index and Load Index. We cannot comment on those measures which are still uncertain in nature (eg Social obligations).

3. CHAPTER THREE – DRIVING SUSTAINABLE NETWORKS

We welcome Ofgem's recognition that distribution network operators have a key role to play in facilitating the transition to a low carbon economy. It is important that this recognition extends to ensuring that the RIIOED1 package, in conjunction with wider policy developments (for example the Electricity Retail Market Reform to Common Distribution Charging Methodologies) do not unnecessarily restrict the ability of DNOs to develop distribution system operator capabilities to more efficiently and effectively meet our future customers needs.

It is particularly important that when DNOs are carrying out any investment activities on their networks that the ED1 package supports cost effective future proofing. For example, this could be simply ensuring smart network components can be retrofitted or specifications that will deliver customer benefits over the lifetime of assets that in some cases will be >80 years. It is important that this

activity is not restricted to asset replacement but also includes new connections activities and effective future proofing is not just required but mandatory for all electricity connections providers.

3.1 ***Question 1:*** *Do you agree that a specific output or incentive focussed solely on the connection of low carbon technologies is not necessary?*

Yes, we agree that a specific output or incentive focussed solely on the connection of low carbon technologies is unnecessary as the adoption of these types of technology are generally determined by factors outside the DNO's control and therefore unlikely to be influenced by the DNO. Placing an output or incentive upon this does not seem appropriate as it is possible that certain technologies are more appropriate to particular geographical locations and there is little a DNO can do to influence this.

An example of this is the connection of larger distributed generators where the DNO can adopt innovative designs that accelerate the planning processes and coordinate with developers to provide connections faster and more efficiently.

3.2 ***Question 2:*** *Do you agree with our proposals on the level of detail DNOs will be required to submit on the different scenarios in their business plans?*

We have worked with the Smart Grid forum subgroups of the DECC and ENA to develop national scenarios and have engaged engineering consultants to localise the impact of these upon our specific networks. Whilst we are engaging with stakeholders to obtain their views of the most likely scenarios (eg. through impact of the energy policies of the Scottish Government, Welsh Assembly, cities, Local Authorities), it is clear that no certainty is possible over:

- Which scenario will most clearly reflect reality
- How clustering will have an impact upon DNO networks

3.3 ***Question 3:*** *Do you agree that an uncertainty mechanism is required to manage the uncertainty around the penetration of low carbon technologies?*

Due to the large differences which can be seen in the DECC scenarios and the considerable uncertainty regarding the potential uptake of low carbon technologies over the price review period, as well as the existing differences in DNO network design, topography, loading and current and future customer mix, we agree that an uncertainty mechanism is required.

This mechanism is likely to need to be calibrated differently for each DNO unless the mechanism is sufficiently granular.

We propose the following:

- Select a credible scenario to set ex ante allowance
- Select range and volumes of traditional solutions to deal with this (including mid-point clustering)
- Select efficient unit costs for traditional solution
- Agree list of triggers for mechanism (e.g. transformer will be overloaded / transformer is overloaded / cable is overloaded)
- Set ex ante allowance for first 4 years (to mid point)
- Allow revenue driver to immediately flex up if exceeded
- Allow revenue driver to flex down from midpoint review (NPV neutral)
- Encourage DNOs to innovate commercially and technically as a result of ERI mechanism (driver feeds into ERI)

3.4 ***Question 4:*** *Do you agree with the three tier approach we propose to introduce for the recovery of the DNOs' costs during the smart metering roll-out?*

We agree that the three tier approach proposed represents a pragmatic solution to the recovery of costs associated with the smart metering rollout.

With respect to Smart Metering, we envisage a number of costs accruing during the ED1 period and propose a flexible approach is taken which permits the DNOs to fairly recover costs. The four categories of costs which we anticipate to result from the smart metering roll out are:

- Additional costs associated with the rollout of the meter which requires DNO intervention to permit the safe installation. This will include the response to existing defects which require rectification as well as new issues such as repositioning of the meter.
- Costs associated with the accession to the Smart Energy and ensuring compliance with the relevant security and data privacy standards as well as wider IT systems which are required to handle the variety of data which will be available
- Charges for the use of the DCC and associated core services which we do not understand will be defined until the CSP, DSP and DCC licensees are appointed.
- An increase in network related issues which we were not previously aware of due to the lack of network visibility e.g. voltage non-compliance.

We do not believe that the existing run rate of defects being identified and rectified in DPCR5 is proportional to the rate which will be experienced during the smart meter rollout as this activity will be far more concentrated than previously experienced. We recommend the development of an ex ante allowance based on a volume forecast with a revenue driver that flexes both ways (up or down) to deal with this uncertainty. We believe a risk to this approach is that Smart Meter installers carry out work inefficiently i.e. the DNO will be called out unnecessarily, thus increasing the cost, and we would expect a mechanism to allow the DNO to recharge these costs back to the supplier.

We note the points raised in the Smart Metering groups that the costs associated with replacing asbestos back boards, meter cabinets and meter repositioning should be funded by the Supplier/Meter installer rather than being socialised by the DNO.

We question whether this approach to customer-owned asbestos is the most efficient solution and whether this approach may result in undesirable behaviour from suppliers; for example, avoiding customers in certain areas where customer-owned asbestos is known to be an issue.

With respect to the costs associated with SEC accession, the IT systems required to process Smart metering data including the potential change to the registration process, and charges for use of the DCC; we recommend ED1 should have a re-opener and uncertainly mechanism to cover these elements. By the time of our business plan submission, these elements are unlikely to be sufficiently clear to make a justified business case on the necessary funding arrangements.

3.5 ***Question 5:*** *Should costs of load and generation growth for existing customers in profile classes 1-4 be socialised, until smart metering data is available?*

We believe that costs of load and generation growth for existing customers in profile classes 1-4 should be socialised until smart metering data is available for each individual domestic customer. This appears to be a sensible approach as DNOs currently have no process by which to identify which customers' increase in demand may have caused an issue. In addition to this, it could also be seen as a barrier to the uptake of low carbon technologies if it is perceived that some customers may be charged whilst their neighbours, by connecting the same technology or device earlier, avoid these costs.

We must also recognise that, even when smart metering data becomes available, there may not be 100% coverage due to opt outs by the supplier (SMETS1 vs SMETS2 functionality) or by customers wanting to maintain data privacy.

We suggest that this position is reviewed at RIIO-ED2 and changed or retained in light of experience.

3.6 ***Question 6:*** *Should DNOs retain the ability to charge existing customers in profile classes 1-4 who install equipment which poses significant power quality issues for the network?*

We believe that DNOs should retain the ability to charge existing customers directly for remedial works as there is still a possibility that a customer within these profile classes could install equipment (welding equipment, for example) which could have a negative impact on the quality of supply of other customers. We believe that the costs should be socialised where it is not possible to clearly identify the responsible customer.

3.7 ***Question 7:*** *If we socialise costs of existing profile classes 1-4 customers, will the use of system charging methodology need to be changed in order to protect IDNO margins?*

The common distribution charging methodology will need to be revised to reflect all policy changes arising from ED1.

4. CHAPTER FOUR – RELIABILITY AND SAFETY

The long term reliability and safety of our network is a fundamental part of our asset management policy. We welcome the continued focus within RIIO-ED1 on delivery of primary outputs and secondary deliverables and will continue to work with Ofgem to ensure the comparability of output measures and assessment of risk.

Safety of our network for members of the public, staff and contractors is a key primary output and compliance with HSE legislation is an essential requirement for all DNOs.

4.1 ***Question 1:*** *What are your views on the primary outputs and secondary deliverables for reliability and safety? In particular: (a) Do you agree that these are appropriate areas to focus on? (b) Are there any other areas that should be included?*

SPEN agree with Ofgem's proposals for primary and secondary deliverables for reliability and safety as outlined in the consultation document. Further detail is required on the Criticality Index and extension of Health Indices and our expectation is that these areas will be outlined in the February policy decision document to enable the DNOs to produce plans and be assessed on a consistent basis.

5. CHAPTER FIVE – ENVIRONMENTAL IMPACTS

SPEN fully share Ofgem's commitment to achieving the UK carbon targets. The measures proposed strive to offer the necessary incentives to further build on our reputational incentive to be the leading Network Operator in the UK. We believe that there could be further improvements in the losses incentive, as detailed in our question responses. We are committed to working with Ofgem through the working groups to arrive at a suitable framework that allows all of the DNOS to work together to realise our aim of carbon emission reduction.

5.1 ***Question 1:*** *Will our proposed approach ensure effective losses reduction actions?*

We believe that Ofgem's proposed approach will be more effective than a losses incentive based on settlements data, which has been widely discredited.

The advantage of a licence obligation is that the duty will apply equally to all LDNOs. By nature of the contractual arrangements, this may be able to be extended to independent connection providers if it is accepted practice and deemed to be the 'minimum scheme' under the license, the Electricity Act and Electricity Connection Charging Regulations. Alternatively, any low-loss component of a new connection could be deemed to be greater than the minimum scheme and funded through ex ante allowances or volume drivers associated with low-loss future-proofing, assuming that a cost benefit can be proven.

We suggest that the licence obligation includes compliance with an appropriate ENA Engineering Recommendation, which would be more detailed than the licence condition.

5.2 ***Question 2:*** *Will our proposed losses discretionary reward provide the required incentive on DNOs to reduce losses? Should this be awarded twice during ED1 or more frequently?*

Given that DNOs can make a greater impact upon network losses than transmission companies (<1% losses for T, c. 7% losses for D), it seems disproportionate to have the same level of discretionary reward for distribution and transmission. We suggest that the discretionary reward for distribution should therefore be a multiple of that for transmission to reflect this difference in potential impact.

We agree that a proposed losses discretionary reward, combined with an ex ante, outputs based approach, will be sufficient to encourage DNOs to manage network losses on the distribution system and to investigate and develop innovative approaches to reducing losses, where cost effective. However, there should be provision for the sharing of best practice across DNOs and the reporting of case studies from trials.

We agree that this should be awarded twice during ED1. This will allow sufficient time between awards to develop and implement significant changes to the way in which DNOS manage losses. The second award, in the final year of the RIIO-ED1 price control period will encourage DNOs to continue to address the management of network losses throughout ED1.

5.3 ***Question 3:*** *Should DNO actions to identify and address electricity theft be encouraged through an approach outside of any losses reduction mechanism? Do you have any views on the proposed approach, or any alternate proposals, that we should consider?*

SPEN prefer the central anti-theft service approach outlined in the consultation paper and believe that working closely with suppliers would lead to the greatest reduction in electricity theft. We would be opposed to a theft reduction mechanism that utilised settlement data to measure theft reductions.

5.4 ***Question 4:*** *Do you think that further guidance should be provided with regard to the use of the "10% allowance" for undergrounding? If so, what form should this guidance take?*

We agree that there is a need for greater clarity on the "10% allowance" in terms of how and when it can be applied. The topic of undergrounding overhead lines is one that the majority of landowners raise when consents are sought to rebuild or refurbish an overhead line. In many cases when a new connection is sought, undergrounding is a condition of planning consent. Interest groups are having a bigger input to the consenting process and accordingly we are experiencing more and more difficulty in achieving consents for new overhead lines or the retention of existing overhead lines.
The form of guidance or clarity needs to include when the allowance can be applied (out of area of NSA or AONB).This is an area where CBA is difficult to apply as a single very small landowner can prevent a project from commencing.

5.5 ***Question 5:*** *Are National Scenic Areas (NSAs) sufficient to allow for effective use of the scheme in Scotland in the protection of visual amenity?*

Our early stakeholder engagement has indicated that an increase in NSA or AONB areas is not a high priority amongst those consulted; however, the interest groups most likely to request such an area have been poorly represented in our analysis to date. We are actively seeking to consult with such interest groups in a single forum to gather opinion in the near future, after which we will be better informed to comment.

We suggest that the mechanism could deal with the growth in AONB or NSA by the scaling of any allowances to reflect actual growth in these areas.

5.6 ***Question 6:*** *Do you agree with our proposals with regard to DNO assessment and stakeholder engagement within the undergrounding scheme?*

We welcome the Stakeholder Engagement aspects of this area. As part of the planning consent process for any new overhead line SPEN fully engage with all local stakeholders. In terms of SPM we have a very close working relationship with the stakeholders of Snowdonia National Park. In SPD where there is a very small NSA catchment area we will fully consult with all stakeholders as part of our Stakeholder Engagement process.

5.7 ***Question 7:*** *Do you agree with our proposed approach for BCF? Do you consider there are any additional elements that should be included within the BCF reporting scope?*

We welcome the proposed approach for BCF. We will work closely with Ofgem in the provision of the necessary information required to formulate the league tables proposed. The reputational aspects of lower carbon emissions are a key driver for SP Energy Networks.

5.8 ***Question 8:*** *Do you agree with our proposed approach to SF6 monitoring, reporting and management?*

We welcome the proposed approach to the management of SF6 on the network. We agree that the processes and reporting need to be further developed and control measures implemented to monitor and minimise the leakage of SF6. However, we do not agree with the drive to reduce the use of SF6 – at present it is the only commercially viable option for MV switchgear. We will continue to work with Ofgem through the Environmental Working Group, the ENA and through our innovation team to ascertain if alternatives to SF6 are commercially viable.

5.9 ***Question 9:*** *Do you agree with our approach for fluid filled cables?*

We welcome the proposed approach to the management of Fluid Filled Cables on the network. We will provide full details of the investment that we wish to undertake to reduce our reliance on such cables as part of the well justified business plan.

5.10 ***Question 10:*** *Do you agree with our approach to noise reduction?*

Whilst the expenditure on noise reduction is relatively low we do undertake noise reduction schemes on our network (e.g. noise reduction around existing transformers) where the cost benefit analysis indicates that this is the most viable option. Accordingly we would like to retain a small proportion of the environmental allowances to undertake such schemes. The level of expenditure is of such a small magnitude that we agree with Ofgem's approach to remove the reporting of Noise Reduction.

5.11 ***Question 11:*** *Do you agree with our assessment of the need for an additional environmental discretionary reward?*

We support Ofgem's proposal to combine the losses and environmental discretionary rewards into a single scheme. We believe, however, that the combined level of reward is insufficient to provide the necessary incentives to drive DNOs to meet the challenging targets set for Carbon reduction, particularly when considering the potential impact that DNOs can have in this area compared to transmission companies.

6. CHAPTER SIX – CUSTOMER SATISFACTION

We fully support the Broader Measure of Customer Service (BMCS) introduced in DPC5 and believe it is an essential framework to drive improvements in customer service across all DNOs. We have been actively involved in Ofgem's Customer and Social Obligations work group and broadly agree with the changes to the incentive for Customer Satisfaction for interruptions and general enquiries. However, we feel that the proposed % increase for Connections is disproportionate considering the volume and value of work undertaken in this area compared with the wider services that DNOs provide. We also believe that sustainable improvements in customer service can be best achieved by fixing targets for the full price review period based on absolute scores rather than mean DNO performance. This approach will encourage DNOs to share best practice, which will benefit all customers in the long term. We believe it is essential for Ofgem to ensure that all DNOs are reporting customer contacts on a consistent basis and applying equal standards of reporting across all contact channels.

We have made significant investments in technology to improve the service we provide to customers, making it easier for them to contact us. Further investment is also planned for 2012/13 to delivery additional improvements and enable customers to contact us in a variety of different methods. We feel strongly that as the BMCS is intended to measure all aspects of our service, the customer satisfaction scores should include all customers, therefore, the inclusion of Unsuccessful Calls within BMCS is essential in providing a fair and standard measure across all DNOs and should be measured for all categories. We also feel that the BMCS should include all inbound contacts via Phone, Email, Text, Web Chat and Online where we have given customers a specific contact channel. We envisage social media being part of our communication strategy to engage customers and seek their views, however, we do not see this as a specific contact channel to be included in the incentive.

In our view, the current measure and weighting of Ombudsman Complaints under DPC5 are treated disproportionately to the total number of complaints received. We would like to see this mechanism revised with a greater focus on direct customer compensation. We would also like to see a reduced weighting on Day 1 complaints to ensure the incentive drives the right behaviour in terms of quality of response to our customers.

6.1 ***Question 1:*** *Do you agree with our proposal to retain the Broad Measure of Customer Satisfaction (BCMS) and increase the maximum revenue exposure?*

We fully support the proposal to retain the framework of the Broader Measure of Customer Satisfaction and feel the spirit of this incentive aims to improve the service provided to all customers we serve.
We fully support the changes proposed to Complaints and Stakeholder Engagement for ED1 and are comfortable with the changes to the incentive for Customer Satisfaction for Interruptions and General Enquiries. We feel however that the % increase for Connections is significant and should not be disproportionate in terms of the overall incentive when compared with Interruptions, given this drives the majority of customer contact. We support the proposed move towards only including major customers where the competition test has not been successful, however we feel that moving the

Minor Connections incentive to 0.5% is a significant change and is not proportionate to the service we are delivering.
The proposal to introduce the "Time to Connect" incentive is, in our view, duplicating the measure which is already included in the Connections Broader Customer Satisfaction incentive and is not necessary for driving improvement in this area. SPEN recognise that this is an area where DNOs need to improve, however, we feel that the current Broader Measure incentive is already driving this improvement and will continue to do so as the incentive matures and plans begin to deliver more fully.

6.2 ***Question 2:*** *We seek views on the approach to setting targets for the RIIO-ED1 period, including whether these targets should be fixed for the price control period or should be responsive to changes in industry performance.*

Our view is that targets should be fixed for the full price review period and that in the case of the Customer Satisfaction Surveys, these should be based on absolute scores and not the mean DNO performance. This will allow DNOs to focus on their own performance and would promote an environment where DNOs are more willing to share best practice with each other.

It should, however, be recognised that initiatives which will occur throughout the price review period, such as Smart Metering rollout, may have unforeseen impacts, and we would welcome the ability to periodically review the impact on targets throughout the price review. We suggest a midpoint review constrained to factors unknown at the time of target setting.

6.3 ***Question 3:*** *We seek wider stakeholder views on whether interruption customers that have been proactively contacted by the DNO via new methods of communication (eg social media) should be included in the customer satisfaction survey.*

Our view is that the incentive should include inbound Phone, Email, Text, Web Chat and Online where we have given customers a specific contact channel. We envisage social media being part of our communication strategy to engage customers and seek their views, however, we do not see this as a specific contact channel to be included in the incentive. With regard to outbound contact to interruption customers (for instance by text), we are happy for these customers to be included in the incentive, on the basis that this would be applied consistently across all DNOs.

6.4 ***Question 4:*** *Should the provision of information to connections customers be taken into account when calculating the score of the customer satisfaction survey?*

The current satisfaction survey already incentivises DNOs on the information provided to customers in relation to the clarity of quotations and price. Where customer expectations are not met in terms of timescale, this is also shown in the satisfaction scores. In addition, competition further incentivises DNOs to perform well in this area. We do not feel any additional information needs to be taken into account as part of this incentive.

6.5 ***Question 5:*** *Should the number of unsuccessful calls be taken into account when calculating the score of the customer satisfaction survey?*

In our view the spirit of the Broader Measure of Customer Satisfaction is to ensure all customers receive an excellent level of service. Given the intention of the incentive, we feel it is important to ensure that the experiences of all customers are taken into account when calculating the score of the customer satisfaction survey, including unsuccessful calls.
If unsuccessful calls are not included in the scoring, a DNO could potentially serve a smaller group of customers very well at the expense of other customers. We feel strongly that the measurement of unsuccessful calls gives a truer picture of the service given to all customers contacting DNOs.

6.6 ***Question 6:*** *What indicators should we use to measure complaints performance? How should these be weighted?*

SPEN would recommend having a low weighting for % Outstanding after Day +1 to discourage the behaviour of raising and closing enquiries to improve apparent performance. To ensure measurement of efficient and effective complaint handling the following is recommended (with weighting):

- % outstanding after day +1 (weighting 10%)
- % outstanding > 14 days (weighting 30%)
- % outstanding >30 days (weighting 30%)
- % repeat complaints within 6 months (currently 12 months) (weighting 30%)

SPEN also believe that the current measure and weighting of Ombudsman Complaints is disproportionate to the total number of enquiries typically handled by a DNO. The penalty should be proportionate to the materiality and nature of the complaint. We propose an increase in the level of compensation the Ombudsman can award to a customer and less focus on penalties for the DNO, which we believe will be welcomed by customers.

6.7 ***Question 7:*** *How should we calculate the BMCS complaints metric target for RIIO-ED1? How should we calculate the score at which the DNO incurs their maximum penalty exposure?*

At present the 'best quartile' score amongst DNO's is used to calibrate the BMCS complaints metric target. SPEN would recommend calculating the metric based on performance against a fixed benchmark, which should be based on historical performance of all DNO's. This would ensure that penalties are applied to the areas of poor performance.

The maximum penalty should apply where performance falls below (i.e. worse than) a multiple of the benchmark figure. However, in setting the range (and corresponding incentive rate at which penalties apply) factors such as the potential distortion of reported performance from the treatment of Ombudsman complaints, should be considered.

It is also important that the target setting is a statistically robust and transparent process. We propose to work closely with the Ofgem team to facilitate this outcome.

6.8 ***Question 8:*** *Do you agree with the proposed approach to assessing stakeholder engagement?*

We support the proposed approach which extends the use of the approach developed for DPCR5. The approach developed for DPCR5, which used two trial years to build experience for all involved in order to improve the process using a 'lessons learned' approach, has worked well. Increasing the reward for exceptional stakeholder engagement from 0.2% to 0.5% sets a clear incentive for DNOs to look at different ways to engage with a wider range of stakeholders in order to achieve improvements extending beyond business as usual.

The use of minimum criteria in the assessment process is helpful from an Ofgem and panel perspective in ensuring that only the best performing DNOs are given the opportunity to present to the panel. From the DNO perspective, it is therefore important that the minimum criteria are sufficiently clear to ensure that a DNO has the ability to demonstrate compliance with those criteria and therefore secure a slot with the panel.

7. CHAPTER SEVEN – SOCIAL OBLIGATIONS

SPEN take our social obligations very seriously and we are acutely aware that a significant proportion of fuel poor customers exist within our operational areas. Throughout our involvement with Ofgem's Customer and Social Issues Working Group we have maintained that vulnerable customers should be a primary focus for DNOs, however, as the role of the DNO develops within the RIIO ED1 period, we would consider participating in a multi agency approach to identifying appropriate energy solutions for customers.

7.1 ***Question 1:*** *Are there additional social issues that the DNOs should address?*

SPEN feel that vulnerability should be the main focus for DNOs by ensuring customers get every possible support during power interruptions. In addition to this we feel we could have a role working with wider agencies to find the best energy solutions for customers. We will continue to be active in the community in promoting health, safety and energy education.

7.2 ***Question 2:*** *Are there any specific outputs that the DNOs could be responsible for delivering?*

In our view, it is extremely difficult to translate social issue initiatives into incentives that can be easily measured and compared. We would propose that social initiatives should be included in the stakeholder engagement incentive. DNOs should be recognising vulnerable customers in their communities, engaging with agencies to identify vulnerable customers, better understanding their needs and delivering services to them directly or indirectly.

Despite having been actively involved in Ofgem's Work Group on Customer and Social Issues, it still remains unclear as to the role the DNO would play in helping fuel poor customers (this has historically been a Suppliers role). SPEN are comfortable to work with other agencies to find solutions for customers both vulnerable and fuel poor. In our opinion, these elements should be included within the stakeholder engagement incentive which will allow us to present initiatives we feel are appropriate for reward.

7.3 ***Question 3:*** *Should a separate funding allowance be provided to enable DNOs to carry out activities in response to social issues?*

SPEN propose that the increased Stakeholder Engagement incentive to 0.5% should include social issues initiatives. In our view, engagement with vulnerable customers during power interruptions should be included in the incentive, however, it would be very difficult to translate this into an individual incentive without making it volume driven, which we consider to be inappropriate. Therefore, we do not believe a separate funding allowance is required.

7.4 ***Question 4:*** *Are DNOs adequately incentivised to engage with social issues as part of the BMCS Stakeholder Engagement Incentive?*

SPEN feel we will be adequately incentivised to engage on social issues as part of stakeholder engagement given the increase in the incentive. We feel this should be proportionate to the other services we deliver and we will already be incentivised indirectly through the customer satisfaction surveys by delivering the right service to the right customers.

8. CHAPTER EIGHT – CONNECTIONS

SPEN have been actively involved in the ED1 consultation process via the Connections Working Group and have extensive experience of competition in connections within SPD and SPM distribution licensed operating areas. We believe Ofgem's proposal for ED1 contains elements that are disproportionate. Whilst the focus on improvements to customer service has been welcomed within

the industry, Ofgem's ED1 proposals have the potential to provide a disproportionately higher level of risk in the connection of both demand and generation connections. In addition, we are concerned that if the targets for the Broader Measure of Customer Service (BMCS) remain relative, then there is the risk that some DNOs could face significant penalties for what may be only marginally poorer performance than others.

We believe that the Distributed Generation Incentive Mechanism (DGIM) should remain, possibly within a revised form to allow DNOs to make targeted investments to facilitate ease of connections in generation rich areas and for multiple speculative projects.

The Average Time to Connect incentive proposals are welcomed by SP for minor customers, although we have concerns that these incentive proposals may not deliver the desired behaviours for major customers. Whilst 'quicker feels better' for minor customers, major customers often want to be connected at the right time rather than sooner.
SPEN do welcome the proposed change in the treatment of customer contributions. The ability for the DNO to consider investment ahead of need, without the threat of such investment being deemed inefficient is welcomed. We also welcome the proposed standard load index categories.

8.1 ***Question 1:*** *Do you consider that our proposed package will drive the appropriate behaviour for connecting both demand connections and generation connections?*

SPEN are of the view that the focus on improvements to customer service has been welcomed within the industry, however, the proposed package has the potential to provide a disproportionately higher level of risk in the connection of both demand and generation connections.

With respect to the Broad Measure of Customer Satisfaction (BMCS), the level of reward / penalty is significant, but if the targets remain relative, then there is the risk that some DNOs could face significant penalties for what may be only marginally poorer performance than others. For example in the case of minor connection customers, the level of financial exposure is broadly 40% of the total turnover associated with these Relevant Market Segments (RMS).

We believe that the Distributed Generation Incentive Mechanism (DGIM) should remain, albeit that it could be more effective if it were amended so as to allow changes in the investments that DNOs can make, i.e. in generation rich areas, to encourage proactive network investment in advance of applications for connection being received, and; the capacity to extend totex to better satisfy developers' needs for levels of information / case studies for multiple speculative projects through the application of technology.

The Average Time to Connect incentive proposals are welcomed by SP for minor customers, although we have concerns that these incentive proposals may not deliver the desired behaviours for major customers. Whilst 'quicker feels better' for minor customers, major customers often want to be connected at the right time rather than sooner. In addition, other conflicting variables (such as private and public consenting processes and DNOs' responses to storm scenarios) may impact upon DNOs' ability to provide quicker connections for major customers, potentially nullifying the perceived benefits of these incentive proposals. It will also be challenging to compare companies' relative performance on time to connect if extended to 'larger' customers, due to the differences in customer mix, network topography, planning regimes, network loadings and connections market shares.

SPEN do welcome the proposed change in the treatment of customer contributions. The ability for the DNO to consider investment ahead of need, without the threat of such investment being deemed inefficient is welcomed.

We welcome the proposal for standard load index categories, as we expect that this will enable Ofgem to provide greater guidance in relation to general load reinforcement triggers (ie not

connecting-customer driven), and enable greater consistency for customers / stakeholders across DNO areas.

8.2 ***Question 2:*** *Is it appropriate to remove the DG incentive?*

We do not believe that the justification for the policy proposals have been fully evidenced to date. We believe the mechanism should be retained with the refinement that the mechanism should be extended to include totex expenditure.

Firstly, given the wide spread in penetration of DG across distribution companies, it seems appropriate that an Operating and Maintenance allowance driver is retained, as we are unclear how the cost assessment process would deal with these costs in an equitable manner.

Secondly, we do recognise that the capital incentive mechanism has only been used to a limited degree, as it is limited to capital costs and also it is challenging to identify with any degree of certainty where generation will connect to our network. However SPEN has used this mechanism to invest commercial resource work with developers who have complementary projects to develop revised connection arrangements which have enabled connections to progress more quickly and also overcome planning consent issues. This mechanism has also been a feature in our significant efforts invested in working with the Welsh Assembly Government, National Grid and renewable developers in mid Wales, where we plan to connect potentially up to 800MW of generation, with planning delays we would expect most of these costs to come through in the ED1 period.

We believe this is clear evidence that the current mechanism has worked effectively where the opportunity has arisen. In addition, we believe that if the mechanism was extended to totex costs then this would provide the opportunity for DNOs to invest in front end systems and processes to improve the information provision for renewable generators, with associated benefits for other connection customers.

8.3 ***Question 3:*** *Do you agree that we should split the BMCS customer satisfaction survey into major and minor connections customers? If not, why not?*

We generally support splitting the BMCS between major and minor customers, as we agree that the needs of larger connection customers can often differ from those of smaller connections customers.

In relation to the reward / penalty exposure on the proposed minor connections survey, we recognise that this is a significant increase from the relevant reward / penalty exposure in DPCR5. Whilst we welcome the opportunity for increased reward, it is worth noting that the level of reward / penalty is disproportionate to the level of turnover experienced by SPD and SPM within the minor connections survey. Typically, SPD and SPM secure c£8-10m of minor connections activity per annum. The level of exposure to reward / penalty based on the current proposal would be c. 40% of annual turnover in this category which seems disproportionate.

Developing a more relevant survey for major customers is welcomed, although we are unable to comment on this, until a draft proposal and definition is presented.

In SPD and SPM, there are some relevant market segments where competition has not developed and whilst competition could develop in these segments before the start of ED1, we are concerned about the level of penalty exposure on a very limited number of connection offers.

We request that Ofgem publish their views on how this major connections customer survey will be scaled depending upon the number of relevant market segments where we have passed the competition test.

8.4 ***Question 4:*** *How should we set targets for the BMCS customer satisfaction survey?*

Our view is that targets should be fixed for the full price review period and in the case of the Customer Satisfaction Surveys should be based on absolute scores and not mean DNO performance. This will allow DNOs to focus on their own performance and would promote an environment where DNOs are more willing to share best practice with each other.

8.5 ***Question 5:*** *We invite views on our proposals for the Long Term Development Strategy (LTDS), Distributed Generation (DG) Connection Guide and Information Strategy (IS).*

We support the retention of the Long Term Development Statement and the DG Connection Guides as we believe that these documents provide a valuable source of information for those interested in a connection to the network and that the wider uptake and understanding of the DG Connection Guides should assist in customers understanding of the connection requirements for all forms and sizes of DG.

Although it is proposed to remove the IS requirement, this should be adequately covered by other measures/licence requirements within the overall package of RIIO-ED1. The introduction of a broader measure of customer satisfaction to larger customers should provide an appropriate incentive for us as a DNO to make the connections process as simple and straightforward as possible and provide an appropriate level of information and assistance to customers seeking a connection.

8.6 ***Question 6:*** *Are additional or alternative incentives required to encourage the DNOs to provide better information to connection customers upfront? If so, what would these measures and incentives be?*

SPEN is committed to establishing new means by which improvements can be made in the quality and volume of information provided to help facilitate more informed decisions by connections customers. The BMCS and DG Information Strategy are a significant driver behind this strive for continual improvement. It should be noted, however, that such improvements in the provision of information often comes at a cost. This cost can either be passed onto connecting customers or be borne by established connected customers through increased DUoS contributions. As is the case for most DNOs, SPEN are often not able to provide the detailed level of information that customers seek, without significant TOTEX investment in SCADA systems and IT infrastructure.

One example in relation to our DG customers is the upfront benefit of providing capacity 'heat maps' down to the secondary network. We currently provide such 'heat maps' on our website for available DG capacity down to primary substation level (33kV/11kV). We are unable however to extend this service to the secondary network. Whilst we continue to seek cost effective solutions for providing this information, we consider that it will inevitably require significant investment to install the required monitoring equipment in thousands of secondary substations, in order to provide the required granularity of information that would allow available capacity at local substations to be provided.

SP believes the DGIM should be retained and 'opened up' to cater for this type of investment to enable improved information provision to our customers.

8.7 ***Question 7:*** *We seek stakeholders' views on the introduction of a new Average Time to Connect Incentive.*

SP generally welcome the introduction of the proposed Average Time to Connect incentive, particularly with respect to measuring the service between two distinct elements: average time to produce a quote; and average time taken from quotation acceptance to completion of works.

Whilst we recognise that the inclusion of major customers groups within the incentive is subject to the number of RMSs that have passed the competition test, we are concerned that the inclusion of the major customer groups within this incentive won't lead to a better service provision. Whilst intuitively it feels right that the provision of a quicker service for minor customers will be welcomed by customers within these RMS, it is important to note that the needs of major customers are often different, with these customers seeking connection when it is required, not necessarily any quicker. In some market segments, the type of connection required can lead to significant differences in the time taken to complete works. For example, in a new build housing development, completion of the full works can often take a number of years, whereas a commercial development can be completed in a small number of weeks. On that basis, we remain concerned that the average time to connect incentive for major customers won't provide any direct benefit and in some cases may incentivise the DNO to complete the connection works in advance of the customer's actual requirements.

8.8 ***Question 8:*** *We seek views on which aspects of service should be measured, the approach used for target setting and whether any exemptions should be applied under the Average Time to Connect Incentive?*

We believe that the targets for the Average Time to Connect incentive should be absolute and not relative to other DNOs' performances. Without having data to assess with respect to this question, it is assumed that there is likely to be significant differences in the average times taken between DNOs and as such relative performance would not be an appropriate measure. DNOs have different topography, in some cases a different network design and infrastructure, significant variances in circuit loading, a different customer mix and varying levels of competition, such that the mix of projects delivered by each DNO will impact actual performance and targets.

Exemptions should be applied to all aspects of this incentive, for example to include delays and differences in private and public consenting processes, DNOs' responses to storm and other force majeure scenarios.

8.9 ***Question 9:*** *Do you agree with our proposed approach for the treatment of connection customer contributions by the DNOs during RIIO-ED1?*

We agree in principle to the treatment of customer contributions. The extension of the current mechanism for high volume, low cost connections to all connections should simplify the overall process, with the same rule applying across all forms of connection.

Clarification in the treatment of these costs particularly in relation to high cost low volume connections is welcome. During DPCR5 the ability of a DNO to carry out reinforcement ahead of identified need was offset against the potential for that investment to be ruled as inefficient, especially if the intended demand failed to materialise. Hence DNOs would tend to be more cautious and wait for an identified customer to trigger the work as this would also allow the DNO to recover (through the apportionment rules) a percentage of the costs from the party driving the required investment. Future parties connecting to that area of network would also be liable for a proportion of these costs, and hence reinforcement costs would be recovered from those parties benefitting from the work.

8.10 ***Question 10:*** *Are additional incentives needed to encourage the DNOs to provide high-quality, timely non-contestable work? If so, what incentives should be applied?*

Yes, we believe that an average time incentive for non-contestable services would encourage DNOs to outperform SLC15 requirements to the benefit of the customer.

8.11 ***Question 11:*** *We seek views on the financial exposure and scope of incentives for those market segments that have/have not passed the Competition Test.*

In SPD and SPM, there are some RMS where competition has not developed and whilst competition could develop in these RMS before the start of ED1, we are concerned about the potential level of penalty exposure on a very limited number of connection offers.
We would also ask that OFGEM publish their views on how the major connections customer survey will be scaled depending upon the number of RMS where the competition test has been passed by the DNO.

In the meantime, whilst we await the outcome of the competition test and OFGEM views on how the major customer survey will be scaled, it is difficult to assess whether the financial exposure is reasonable or not.

9. CHAPTER NINE – EFFICIENCY INCENTIVES AND IQI

IQI is now an established part of the price control process, having been used in DPCR5, RIIO-T1 and now RIIO-ED1. We believe that the IQI mechanism in previous price controls has incentivised accurate forecasting of expenditure, and we are supportive of its inclusion as part of the RIIO-ED1 process.

We are concerned that the proposed calibration of the Information Quality Incentive (IQI) and Efficiency Incentive Rate (EIR), in combination with the lower scrutiny for fast track companies, results in a clear incentive for companies to adopt an overly aggressive and optimistic approach to their ED1 bid in an effort to obtain additional rewards whilst minimising regulatory scrutiny.

There is an interaction between the cost assessment process and the outcome for DNOs under IQI. Historically, the overwhelming majority of IQI ratios have been well in excess of 100. If Upper Quartile benchmarking is used to form the DNO's allowance and Ofgem view in the IQI process this will continue.

The relationship of the proposed IQI matrix and setting allowances at the upper quartile will make it almost impossible for a DNO who accurately forecast their costs to earn their allowed return on equity. At the highest level, quartile benchmarking ensures that 75% of DNOs will have negative additional income. This fraction can only increase as weighting is given to any disaggregated results.

We believe that the proposed matrix is consistent with mean rather than upper quartile benchmarking. If Ofgem wish to use an upper quartile benchmark the proposed matrix must be replaced with a positive additional income matrix similar to the revised RIIO-GD1 matrix / DPCR5 matrix.

We believe that the mean benchmark is inherently more robust than a quartile benchmark, and on the basis of mean benchmarking only would shareholders accept the proposed matrix.

We estimate that use of the matrix in the September Strategy Consultation together with a quartile benchmark (or with a distribution of IQI ratios similar to those at GD1 and DPCR5) reduces the expected return on equity by around 100bp relative to DPCR5.

It seems logical to extend the Efficiency Incentive to a broader range of costs. We note that the proposed rate for RIIO-ED1 is around 5% higher than the effective rate at DPCR5. We estimate this provisionally as an increase in risk of 15-20bp, and would expect that this be taken into account when setting gearing and cost of equity.

9.1 Question 1: *Do you agree with our proposed range for the efficiency incentive rate?*

We agree with the proposed range, provided the increase in risk arising is visibly reflected either in the allowed cost of equity or lower gearing.

SPEN's DPCR5 ratio would now attract a rate of 60% under ED1 compared to DPCR5 average of 56% (across IQI and pass through). This risk (expressed in terms of RoRE) depends not only on the increase in incentive rate, but the size of the planned expenditure relative to the existing RAV. A preliminary RoRE estimate suggests (as an example for SPD) that the risk increase associated with incentive rate change only might be 15-20bp relative to DPCR5 for a 5% overspend at the average IQI ratio.

9.2 Question 2: *Do you agree with our proposed approach to the calibration of the IQI?*

We believe the proposed IQI calibration approach is flawed and requires material revision.

The proposed IQI matrix has a significant downward impact on Return on Equity relative to DPCR5 via the very large downward adjustment to the IQI associated income. We provisionally estimate the reduction in expected return on equity due to the adjustment in IQI income alone at around 100 basis points for a DNO at an IQI ratio close to the DPCR5/GD1 average.

Historic evidence suggests Ofgem's cost assessment process is skewed to deliver IQI ratios typically well over 100. It is proposed by Ofgem that allowances will be set by quartile benchmarking, in which case the range of ratios in RIIO-ED1 are unlikely to be more favourable. The results of the IQI for RIIO-GD1 would also support this view.

The inevitable outcome for the majority of DNOs, from the proposed revisions to the IQI range, is an expected return lower than the allowed cost of capital. In RIIO-GD1 the lowest ratio achieved was 107 with an average of 113. The average GDNO under the proposed ED1 Matrix would have been liable for an additional 'income' penalty of around 2.5% of totex, and the best performing GDNO a penalty of over 1.2% of totex.

Further, a rational business should optimise its IQI position by forecasting (then targeting) the lowest realistically achievable cost. Therefore if the IQI incentive works, the opportunity for any business to outperform is severely limited, and risk under the efficiency incentive is further heavily skewed to the downside.

This downside skew will be increased by the application of a threshold to levels of overspend before any uncertainty mechanisms are triggered, and by the further suggestion in paragraph 9.12 of the Outputs, incentives and innovation paper that DNOs will be exposed via this incentive to the risk of funding any necessary but unanticipated activities not explicitly subject to a re-opener.

It is our view that the proposed matrix is consistent with mean benchmarking. Upper quartile benchmarking would require a suitably calibrated matrix more closely resembling the DPCR5 or revised GD1 matrices.

We would welcome the IQI matrix calibration being fixed in the February policy decision document as this would simplify the risk calibration process.

9.3 Question 3: *What are your views on the indicative IQI matrix?*

We are concerned that the proposed calibration of the Information Quality Incentive (IQI) and Efficiency Incentive Rate (EIR), in combination with the lower scrutiny for fast track companies, results in a clear incentive for companies to adopt an overly aggressive and optimistic approach to their ED1 bid in an effort to obtain additional rewards whilst minimising regulatory scrutiny.

We believe the IQI matrix from DPCR5 should be retained. The matrix proposed in ED-1 will result in a DNO being penalised via loss of allowance and penalised again via negative additional income through the IQI.

In DPCR5 any additional income under IQI was offset by the gap between forecast and allowed expenditure for a DNO with an IQI ratio greater than 100.

For the reasons outlined above we believe that the change to the additional income in the proposed IQI matrix would result in a substantial reduction in the expected return on equity, of the order of 100bp.

In relation to paragraph 9.31 of the Outputs, incentives and innovation paper we expect the application of the IQI Matrix to be normalised for outputs.

9.4 ***Question 4:*** *What do you consider are the appropriate rewards for fast-track companies compared to non fast-track companies? Should we have a differential between the two?*

The same matrix should be applied to fast and non-fast track business plans. Fast track companies should benefit from an IQI ratio of 100. Other companies may be slow-tracked because of other elements of business plan so should not be denied the opportunity of maximum IQI performance. We note that together paragraphs 9.3 and 9.17 of the Outputs, incentives and innovation paper imply that a company might have to be fast-tracked to earn its allowed cost of capital.

9.5 ***Question 5:*** *Do you agree with our proposals for the same efficiency incentive rate to apply to all areas of expenditure that will be included within the IQI?*

Yes. However, in relation to paragraph 9.26 of the Outputs, incentives and innovation paper we do not believe that the forecast of RPEs should be included in the IQI Mechanism.

Any business which (accurately) forecast RPEs higher than the Ofgem forecast would be exposed to an unjustified loss of additional income simply because of the inherent uncertainty in forecasting. RPEs are not comparable with the wider IQI process, where it is possible to form an absolute (if still uncertain) view of efficient cost and how forecast cost relates to this.

RPE risk should not form part of the IQI mechanism, but should be dealt with via an appropriate and distinct uncertainty mechanism.

9.6 ***Question 6:*** *Do you agree with our proposed treatment of DNOs within a single ownership group?*

The proposed approach differs from that used for DPCR5 (aggregated costs across group members) and for RIIOGD1 (average IQI ratio for group members, which should be equivalent to unweighted average of rates), and results in a small difference in incentive rate.

Given that regardless of fast-tracking or otherwise, Ofgem intends to equalise the incentive rate across members of a group, the incentive rate for a fast-track company will be subject to revision in the light of the outcome for other group members.

We believe that for consistency it is preferable to derive the rate from an aggregate IQI position than simply to weight the individual rates by share of Totex.

It is important to ensure that single rate setting doesn't introduce any anomalies whereby a DNO is unfairly advantaged or disadvantaged simply by belonging to a group where one or more of the other DNOs have been fast-tracked.

10. CHAPTER TEN – ENCOURAGING INNOVATION

We are strongly in favour of the Ofgem proposals on Innovation Funding and welcome the three components - NIC, NIA and IRM. Our parent company, Iberdrola, is the only electricity utility to have been included in the ranking of the top 1000 companies in R&D investment worldwide, drawn up by U.S. consultancy firm Booz & Company. We therefore recognise the need for an innovation strategy which outlines our approach not only to the NIA and NIC, but also how innovation forms an integral part of our overall business plan submission and how innovation is an essential element of our business as usual activities.

10.1 ***Question 1:*** *Do you agree that the cap on funding for the electricity NIC should be within the range of £60m and £90m for 2015-16 and 2016-17? Please provide evidence to support your suggested level of funding.*

Based on the uptake and continued interest in the LCNF Tier 2 to date, and the level of interest that has already been expressed by Transmission Owners in the NIC for the RIIO-T1 period, we would be in favour of the allowance set at the upper limit of £90m for 2015-17.

The reasons for this are two-fold. The Tier 2 limit of £64m has remained the same through the DPCR5 period, thus decreased in real terms. The continuation of a similar level marks a marginal decrease over time. Additionally, the selection process of NIC projects allows for the assessment of whether or not they provide value for money. Given the uncertainty over the variety of ideas and scale of projects, we do not perceive there to be any down side to setting the cap at the upper limit (£90m) as the selection process will ensure that projects which create the greatest potential value for money progress. Should the projects that are proposed not provide adequate value, Ofgem are not obliged to award the full amount of money.

10.2 ***Question 2:*** *Do you agree that the level of funding for the rest of the ED1 period should be reviewed in 2016 following a review of the LCN Fund?*

A review would be appropriate but we also believe that a minimum funding level for the entire price review should be set to provide some degree of certainty. We feel that 2016 would be appropriate as a number of projects will have concluded at that time.

10.3 ***Question 3:*** *What are your views on the information DNOs should provide in their innovation strategies? How can DNOs best demonstrate that their approach to innovation is sufficiently well justified and robust?*

We recognise the need for an innovation strategy such that DNOs can outline their approach to not only the NIA and NIC, but also how innovation forms an integral part of the overall business plan. Albeit a range of NIA allowances have been proposed, we note that no GDN or TO was awarded an allowance of more than 0.7% and would request that further information is provided to clarify Ofgem's expectation of an innovation strategy which merits the upper limit of the allowance. The feedback provided to date on these strategies has not provided sufficient clarity on Ofgem's expectations on the innovation allowance and we note the feedback from some stakeholders who were in favour of allowing the licensees to have a higher allowance.

It should be recognised that an innovation strategy cannot be prescriptive as innovation by its very nature changes over time depending on the evolution of projects.

10.4 ***Question 4:*** *Do you agree that it would be valuable for DNOs to consult and update their innovation strategies regularly during the price control period?*

As per our response to Q3, it needs to be recognised that an innovation strategy will evolve over time depending on technology and other developments. Our view is that updating this strategy is a

reasonable requirement to ensure it is relevant. The frequency of such updates should not be specified as the strategy should be at a sufficient level to allow a degree of flexibility in a DNOs approach to be able to respond to new challenges and opportunities as they arise. An innovation strategy, like any other strategy should be for a sufficient period of time for it to be executed; otherwise it risks merely becoming a plan of activities due to its short term focus.

We would also agree that consultation with stakeholders is required to help shape the strategy; however it cannot be overlooked that the technological advancements will also dictate the development of an innovation strategy. In our view a successful innovation strategy is a balance of stakeholders requirements (market pull) as well as technology and commercial developments (technology push).

10.5 ***Question 5:*** *Are there any aspects of the innovation framework for ED1, which you think should differ from the arrangements from RIIO-T1 and GD1? If yes, please explain why.*

We are supportive of the innovation principals that have been proposed for ED1 and do not see any significant areas that require to be changed from the arrangements for T1 and GD1 other than the suggestions highlighted above.