



**Electricity North West**

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22 January 2014

Dear Hannah

**Formal response to RIIO-ED1 Business plan assessment and fast tracked consultation**

Thank you for the opportunity to respond to your consultation on the RIIO-ED1 Business plan assessment. We are obviously very disappointed that the Electricity North West plan was not selected to be fast tracked. We are very proud of our business plan and are pleased that it was largely accepted and that Ofgem recognises the efforts that we have put into the plan for the customers of the North West. We are now in the process of reviewing the feedback and analysis to determine the implications for our March plan submission.

We submitted a balanced and financeable business plan package in July. Several elements of this package will need to change as a result of the fast track decision. One of the key aspects of our plan is the financeability package which was initially resolved using the fast track settlement. We will work with Ofgem to identify an appropriate, acceptable and financeable package for the RIIO-ED1 period. Unfortunately, this will have implications for our customers (including the £25 million revenue deferral in 2014/15 offered as part of the fast track package). Whilst Ofgem assessed this mechanism as being neutral to customers in its publication, we recognise that it would have made a difference to our customers next year. For this reason we have voluntarily reduced prices for all of our domestic customers in 2014/15 by £5 and this is being passed through to customers by the electricity suppliers.

We have reviewed the feedback from the consultation document and the cost assessment analysis published on 6 December 2013. The cost efficiency of the plan was the main area of Ofgem's concerns (separately identified as approximately 2% above Ofgem's modeled cost). Our initial review of the models suggests that the 102% totex assessment could have easily been 98%. Our review concluded the approach in some models has had a disproportionate effect on the reported efficiency of our plan. We highlighted a number of these issues in our bilateral meeting and look forward to working with Ofgem to review the qualitative variations from modeled results for the March submission.

Ofgem noted its concerns with our request to recognise the embedded fixed costs of operating as a single licensee (where other companies can share these costs across two, three or four networks). We are keen to explore what further evidence or assurances are required to support an adjustment to recognise the fixed costs that we incur as a single licensee. We are disappointed with Ofgem's statement that customers would not be protected if our position as a single network changed as Ofgem had previously noted that the efficiency sharing factor would protect customers and ensure they share in the benefits of future mergers. This mechanism was successfully applied for the last DNO merger in April 2011.

Continued inclusion of Ofgem's assessment of the cost of equity in the IQI analysis would be inappropriate for the proportionate treatment/slow track determinations. Whilst this approach may have some rationale in a fast track decision (where the balance of a package is tested), it should not be utilised when setting allowances. As Ofgem will set the cost of capital for companies, there is no potential for trade-offs between financing costs and network costs in resubmissions. Ofgem should, therefore, reflect the market risk and the risk of the proposed cash flows in the cost of equity. Utilising the fast track assessment approach could result in companies being penalised twice for a lower cost of equity decision (with both a cost of equity cut and a reduction of revenues through the IQI penalty).

We are currently working with our customers, stakeholders and investors to resolve a number of the issues described in this letter. At this point, engagement with Ofgem at all levels is crucial to meet our mutually objective of developing a well justified business plan package for resubmission that will be accepted at the July consultation.

We look forward to working with Ofgem in the coming months. Please do not hesitate to contact me should you have any queries.

Yours sincerely

**Paul Bircham**  
Regulation Director