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Your Ref:

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Dear James

Consultation on the draft RIIO-ED1 Losses Discretionary Reward Guidance Document

This is the response on behalf of Northern Powergrid (Northeast) and Northern Powergrid (Yorkshire) to Ofgem's "Consultation on the draft RIIO-ED1 Losses Discretionary Reward Guidance Document".

It is useful to have guidance on Ofgem's expectations for the Losses Discretionary Reward at this time. We acknowledge that it may be changed through time, particularly once we have experience of tranche one. We are broadly supportive of the proposals set out by Ofgem in its consultation document. However, most materially, we consider that it would be useful if Ofgem sets out more clearly its expectations on losses in respect of the practicalities and the value as assessed by cost benefit analysis, and in respect of companies' starting positions and how that influences the expected level of innovation. These expectations are relevant to the base licence obligation as well as the discretionary reward.

1 Is the Guidance clear and comprehensive, covering all relevant matters? If not, what specific information have we missed?

1.1 Ofgem expectations

There is a lack of clarity over what Ofgem expect DNOs to do with regard to losses and whether it should be reasonable in light of the practicalities and the value as assessed by cost benefit analysis.

Licence condition SLC 49.2 states "The licensee must design, build, and operate its Distribution System in a manner that can reasonably be expected to ensure that Distribution Losses are as low as reasonably practicable." This is a sensible and relatively clear obligation.

However in the consultation paragraph 3.4 states "DNOs will have the opportunity to evidence how these processes and methods will (or have already) enable them to undertake additional losses reduction actions beyond those required to meet their general licence obligations." It would appear from these two statements that Ofgem is intending to incentivise the DNOs to go beyond what is reasonably practical.

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It is not clear how far beyond what is reasonably practical DNOs are expected to go, or how for the purposes of the losses discretionary reward (LDR) the value of the benefit should be assessed. We note that in the ED1 price control review, losses reduction actions were assessed via the Ofgem's mandated monetised social benefit CBA and therefore we would understand that to be the benchmark for SLC 49; does the LDR require a greater benchmark?

1.2 Advantages conferred by poor starting position

Given certain DNOs were allowed funding for losses management in the recent ED1 review it would seem that they should not receive reward for these activities under the LDR. However another DNO which did not receive funding might be entitled to receive reward for the same actions. This might be taken as DNOs which did not fully commit to losses reduction in their ED1 business plans being at an advantage in the LDR. This should not be rewarded.

However areas of activity where no DNO received specific funding should be considered as reasonable areas to reward.

It would be beneficial if this was confirmed.

2 We have provided details of how we envisage the focus of each tranche changing over the course of RIIO-ED1. Do you agree with what we are proposing?

The tranches move from preparing the losses management effort by setting up the processes, to showing progress through those processes, to showing the results of these processes.

This seems to be a reasonable approach although showing the results of losses management is dependent on successfully developing a method for measuring losses for introduction in the ED2 period in an accurate and timely manner. It is not clear yet how this will be achieved as even the methods involving smart meter data appear to be input based estimates of the outputs of losses management actions, not actual measures of the outputs. Considerable work will be necessary in this area and it is therefore appropriate that tranche three focusses on this issue.

3 Is the submission process for the first tranche clear?

The submission process itself is clear, although as mentioned previously the expected hurdle and the level of evidence to justify it are not.

4 Do you agree with the four criteria that DNOs will be required to provide evidence against?

Three of the four criteria seem to be entirely reasonable:

- Understanding of losses
- Effective engagement and sharing of best practice with stakeholders on losses
- Processes to manage losses

However the fourth criterion, "Innovative approaches", requires further definition and guidance. If one assumes a uniform starting position where all companies are fully exploiting traditional approaches, then no further comment would be necessary; all traditional approaches are exhausted and innovative approaches are the only next step. However given that the companies are starting from different positions, as evidenced by the losses specific funding allowed to some but not all DNOs in the recent review, the position is a little different. How for example would Ofgem value an organisation making noticeable strides on losses management through traditional approaches that it had not pursued previously? It would seem reasonable that if there are low risk approaches that would achieve noticeable gains then these should be the areas of early concentration; but if we only reward companies that are innovative then we punish companies for their starting position or we encourage them to pursue higher risk (on the assumption that new solutions are higher risk) solutions when lower risk ones are available. It would be better to expect companies to make appropriate use of innovative solutions; noting that "appropriate" for a company that still has significant gains to

be made by traditional solutions might be a very low hurdle; however this should be considered in line with our comments in 1.2 above if companies appear not to have been committed to loss reduction in their RIIO-ED1 business plan submissions.

5 Is the assessment process clear?

The stages of assessment, the four criteria for assessment, the possibility of Ofgem asking supplementary questions and the 28 day consultation via Ofgem's website are clear.

It is also clear that to qualify for any level of reward an acceptable submission against all criteria must be made and that the level of reward made will be dependent on how much better than merely acceptable the submission was in each area.

However the assessment process within each stage and how the submissions will be assessed against the criteria is not clear. It appears to be a judgement by Ofgem. We recognise that with the subject area of losses encompassing technical, social, environmental, financial and commercial areas there could be a broad range of expertise required to assess submissions and make reasoned judgements. We are pleased therefore with the pragmatic and reasonable approach Ofgem has taken in noting that external expertise may be required in the assessment of tranche one to supplement the in-house expertise. This is an approach that should continue in the later tranches too.

6 6. Do you agree with the process for allocating the reward amount between successful submissions?

Yes

Yours sincerely

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