

James Veaney  
Head of Distribution Policy  
Ofgem  
9 Millbank  
London  
SW1P 3GE

By email only to: [riio.ed1@ofgem.gov.uk](mailto:riio.ed1@ofgem.gov.uk)

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Dear James

### **Consultation on the draft Losses Discretionary Reward Guidance Document**

Thank you for the opportunity to respond to the above consultation. This letter should be treated as a consolidated response on behalf of UK Power Networks' three distribution licence holding companies: Eastern Power Networks plc, London Power Networks plc, and South Eastern Power Networks plc. It is not confidential and can be published via the Ofgem website.

We note that Ofgem have progressed the drafting of this document from the versions informally circulated to DNOs in February. We are pleased that many of the points we raised have been taken on board but conversely are disappointed that a number of the issues we identified remain. We are happy to meet and discuss these with you to help ensure that a robust and fit for purpose guidance document is finalised.

We note that Ofgem has acknowledged that our published losses management strategy is comprehensive and has been demonstrated as industry-leading during the recent development of Ofgem's report responding to the EU Energy Efficiency Directive regarding network efficiency measures. Since none of the measures described in our losses management strategy called for (or received) specific funding in our Business Plan we would reasonably expect all of these measures to be eligible as 'additional actions'. Clearly as other DNOs have the opportunity to either adopt our losses strategy in its entirety, or selectively incorporate specific initiatives as 'additional actions' within their revised losses strategies, it would be inappropriate not to allow UK Power Networks to also cite these 'additional actions' as legitimate contributions towards meeting the discretionary reward criteria under each of the three tranches of the scheme.

Our answers to the consultation questions are provided in the appendix to this letter and we hope that you will find our comments helpful. If any part of our response requires further explanation or clarification, please do not hesitate to contact me.

Yours sincerely

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

Keith Hutton  
Head of Regulation  
UK Power Networks

Copy: Paul Measday, Regulatory Returns & Compliance Manager, UK Power Networks

## Appendix

### **Q1. Is the Guidance clear and comprehensive, covering all relevant matters? If not, what specific information have we missed?**

We have provided details in respect of this question in our answers to the subsequent questions.

### **Q2. We have provided details of how we envisage the focus of each tranche changing over the course of RII0-ED1. Do you agree with what we are proposing?**

As previously raised, the section on tranches 2 & 3 are unclear and do not give DNOs the certainty of regulatory direction. Phrases such as “we anticipate” and “we expect” do not give DNOs certainty and coupled with an unclear consultation and change process (specifically re timescales) for the scope of tranches 2 & 3 mean that work is required in this area. A solution to this would involve removal of the wording such as “we anticipate” from paragraphs 3.6 to 3.8 and the bolstering of the wording in 3.9 to confirm when and how stakeholders and specifically DNOs will be able to provide input into development of the guidance for the assessments for tranches 2 & 3.

### **Q3. Is the submission process for the first tranche clear?**

The submission process for the first tranche is clear although paragraph 4.1 is duplicated by paragraph 6.5 and should therefore be removed and replaced with a signpost to 6.5.

### **Q4. Do you agree with the four criteria that DNOs will be required to provide evidence against?**

The four criteria, but specifically the first are light on detail. This is specifically important for the first (understanding of losses) as one short bullet has equal weighting as the four more detailed bullets in the second criteria (effective engagement and sharing of best practice with stakeholders on losses). We would appreciate further clarity and detail being provided to mitigate this mismatch.

Furthermore, there are two specific points of clarity in the drafting for the second criteria:

- The second bullet, “etc.” can be removed as it is superfluous with the inclusion of “e.g.” in the same sentence; and
- The third bullet refers to “relevant stakeholders” whereas the rest of the section uses the term “stakeholders”. It is unclear if this is an error or an intentional difference. If it is the latter then an explanation of the reasons behind this would be appreciated.

### **Q5. Is the assessment process clear?**

It is unclear whether a scorecard process is being used to assess the submissions, or if one isn't being used, on what objective basis the pass/fail criteria are being implemented such that a licensee or other interested party could take a view on the objectivity and fairness of the process Ofgem go through.

Furthermore, additional details of the Q&A process referred to in 5.2 would be useful such that both Ofgem and the licensee are clear of the timescales etc. which are required to be worked to.

Finally, we would appreciate an explanation of the reasoning behind the decision that should a licensee fail one of the criteria listed in section four then it would be ineligible for any of the reward even if it as excelled in the other three criteria. An understanding of this is particularly important

bearing in mind the current lack of detail on the mechanism to decide whether a licensee has passed or failed.

Finally, a paragraph should be added confirming that Ofgem will inform the DNOs of their success or failure and the reasons behind these. This is to help ensure understanding of best practice so DNOs can learn for future tranches and also to create an open and transparent reward process.

**Q6. Do you agree with the process for allocating the reward amount between successful submissions?**

The reward allocation seems overly simplistic in the following ways:

- Paragraph 5.6 describes a simple division of the £8m pot between the number of submissions received that have passed the assessment criteria.
- Paragraph 5.8 refers to a simple division of the reward calculated in 5.6 between the licensees in each group.

These do not take into account the relevant sizes of each licensee as illustrated below in a simple example:

Total pot £8m

Group 1 has two DNOs, one which is twice as big as the other, say 2million and 1million customers respectively

Group 2 has three DNOs, two are equivalents to the DNOs in Group 1 and the other is also a large DNO, say 2x2million and 1x1million customers respectively

Group	Group Reward	No. of Customers	Cost per customer on average per DNO group	DNO	No. of Customers	DNO Reward	Cost per customer in specific DNO
1	£8m/2 groups = £4m for Group 1	2m+1m = 3m customers	£4m/3m = £1.33 per customer for that DNO group on average	A	2	£4m/2 = £2m	£2m/2m = <b>£1.00</b> per customer in this DNO
				B	1	£4m/2 = £2m	£2m/1m = <b>£2.00</b> per customer in this DNO
2	£8m/2 groups = £4m for Group 2	2m+2m+1m = 5m customers	£4m/5m = £0.80 per customer for that DNO group on average	C	2	£4/3 = £1.33m	£1.33/2m = <b>£0.665</b> per customer in this DNO
				D	2	£4/3 = £1.33m	£1.33/2m = <b>£0.665</b> per customer in this DNO
				E	1	£4/3 = £1.33m	£1.33/1m = <b>£1.33</b> per customer in this DNO

**Other points not specifically covered by questions**

There are a small number of points that we feel need to be addressed that are not logically fit into the answers to the earlier questions. These are set out below:

1. The term “additional actions” in paragraph 2.1 is unclear – in what respect they are additional?
2. Figure 2 is misleading as it is termed “indicative” but includes a firm deadline for the submission

3. Paragraph 6.1 should refer to a pdf document which is a better format for submissions
4. In paragraphs 6.1 and 6.2 it is not clear why an arbitrary page limit has been imposed. If a page limit is required it should be set higher than this, especially in the appendices, to allow for the DNO to fully evidence its submission. It would be unfortunate if a DNO was deemed to have failed a criteria by not providing enough evidence when the DNO was constrained from providing that evidence by the page limit. We propose a 25 page main document limit and a 50 page appendix limit. This increased page limit would also allow a multi DNO group to include evidence which maybe pertinent for one of its DNOs only which might otherwise have been excluded by the page limit.
5. Paragraph 6.3 should refer to “group” not “company” as licensees as also companies in their own right.
6. Paragraph 6.5 should be amended to make it clear that not “all submissions” are required by 31 January 2015, only those for tranche 1 are required by this date. Future submission dates are subject to consultation as we highlighted in our answer to Q2.
7. Under paragraph 3.6, Ofgem’s expectation is that DNOs would be able to provide evidence of actions they have taken ‘outside of business as usual activities’ to improve their operations in respect of managing losses including, where appropriate, demonstrating how they have built upon the processes set out in tranche one. However, it is important to recognise that embedding new actions as ‘business as usual’ is a continuous process and so what constitutes an ‘outside of business as usual activity’ will continuously evolve over time.

We also note that under 4.2c Ofgem’s expectation is that when considering processes and methods to manage losses on their networks this would include DNOs taking into consideration what other companies consider ‘business as usual’ but may not be employed by the DNO making the application under the LDR. Clearly it would be inappropriate for a DNO to be advantaged simply by replicating an action by another DNO as an ‘outside of business as usual activity’ if that other DNO was precluded from also including that action in their submission simply because they were further advanced in embedding actions as business as usual.

We propose, therefore, that Ofgem amends the ‘business as usual’ criteria and instead considers any effective action not already funded through a DNO’s RIIO-ED1 settlement to be eligible. Moreover, if a company is able to demonstrate that they are pursuing actions described in a well-documented losses management strategy, that company should be given favourable consideration in terms of meeting the LDR criteria