



**To: Electricity North West Ltd (ENWL)
Northern Powergrid (Northeast) Ltd (NPgN)
Northern Powergrid (Yorkshire) plc (NPgY)
London Power Networks plc (LPN)
South Eastern Power Networks plc (SPN)
Eastern Power Networks plc (EPN)
SP Distribution plc (SPD)
SP Manweb plc (SPMW)
Scottish Hydro Electric Power Distribution plc (SSEH)
Southern Electric Power Distribution plc (SSES)
West Power Distribution (West Midlands) plc (WMID)
West Power Distribution (East Midlands) plc (EMID)
West Power Distribution (South Wales) plc (SWALES)
West Power Distribution (South West) plc (SWEST)**

Direction as required under Part C of Charge Restriction Condition (CRC) 2G (the Losses Discretionary Reward) to issue the Losses Discretionary Reward Guidance Document.

Each of the companies to whom this document is addressed is the holder of an electricity distribution licence granted or treated as granted under section 6(1)(c) of the Electricity Act 1989 (the Act).

In accordance with Part C of CRC 2G (the Losses Discretionary Reward) the Authority¹ gave notice on 7 August 2015 ("the Notice") to consult on the proposed text of the Losses Discretionary Reward² (LDR) Guidance Document and the proposed date by which it should take effect. The Notice required any representations to be made on or before 7 September 2015.

Prior to the close of the consultation period in respect of the Notice, we received five responses. All responses have been published on our website.

We have carefully considered all representations received and our responses are contained in Annex 1.

In accordance with our powers under Part C of CRC 2G, we hereby issue the LDR Guidance Document as contained in Annex 2. This decision will take effect on and from 7 October 2015.

This document constitutes a direction issued by the Authority under paragraph 2G.11 of CRC 2G.

**Andy Burgess
Associate Partner, Electricity Distribution, Smarter Grids and Governance
Duly Authorised on behalf of the Gas and Electricity Markets Authority**

7 October 2015

¹ The terms "we", "us", "Ofgem" and "the Authority" are used interchangeably in this letter. The Authority is the Gas and Electricity Markets Authority. Ofgem is the Office of the Authority.

² <https://www.ofgem.gov.uk/publications-and-updates/notice-under-part-c-charge-restriction-condition-2g-losses-discretionary-reward-consult-losses-discretionary-reward-guidance-document>

Annex 1 – Responses to the representations received

- One DNO raised a concern about the competing requirements of SLC 49³ and the LDR. The concern is that any process improvement that has a clear link to value-for-money investment or to something that was reasonably practicable, may not qualify for the LDR as it would already be within the scope of the requirements under the SLC 49 obligation.

We acknowledge this point. SLC 49 requires DNOs to keep losses as low as reasonably practicable on their Distribution System. In doing so, DNOs are required to act in accordance with their Distribution Losses Strategy, which they must maintain and keep under review. In reviewing their Strategies we expect DNOs to modify and update them to reflect the latest losses environment and to accommodate lessons learnt and stakeholder feedback.

The LDR is not intended to reward DNOs for the activities associated with the ongoing review of their Distribution Losses Strategy. This is a requirement of their licence.

Instead, the LDR may reward those companies that are prepared to accelerate the process of exploring and implementing processes and procedures that might significantly shift the expectations of what DNOs are capable of doing to reduce losses. Over the course of RIIO-ED1, this work may reveal activities that we will then expect to see incorporated into the Distribution Losses Strategies of all DNOs in accordance with their licence.

We have updated paragraphs 2.3, 2.4, 3.4 and 4.3 in the LDR Guidance Document ('the Guidance') to reflect this.

- Several DNOs requested more clarity and detail in the guidance on the assessment criteria and how we will score submissions. This included whether we would use a scorecard during the assessment process, the weightings of each of the assessment criteria and a suggestion that we should employ a stakeholder panel to strengthen the assessment process.

The guidance states that in the first tranche of the reward, each of the assessment criteria will have equal weighting. As stated in our response to the March consultation⁴ this is to encourage DNOs to submit a well-rounded submission that addresses all of the relevant assessment areas.

We do not intend to provide more specific guidance as to how the submissions will be scored other than to reiterate that the scoring is discretionary and as part of any decision to issue a reward (including no reward), we will provide feedback on how we reached our decision. This is consistent with the approach taken for other RIIO-ED1 discretionary incentive schemes.

As the guidance document indicates we may use expert help at any point in the assessment process to help inform our assessment of submissions. This point was

³ SLC 49 requires licensees to ensure that Distribution Losses from its Distribution System are as low as reasonably practicable and to maintain and act in accordance with its Distribution Losses Strategy.

⁴ See Q5a - https://www.ofgem.gov.uk/sites/default/files/docs/2015/08/150807_-_tm1_1.pdf

made clear in our RIIO-ED1 strategy decision.⁵ We do not believe that an expert panel is necessary for our assessment of the first tranche of the LDR. The assessment process will, however, be subject to consultation ahead of tranches two and three.

- One DNO stated that it would be inappropriate for a DNO to be advantaged by simply replicating the action of another.

In our response to the March consultation, we made it clear that we will not reward a DNO for simply replicating the actions of another. We updated the 'processes to manage losses' assessment criterion to reflect this. However DNOs are encouraged to have processes in place to understand the actions undertaken by others and consider whether these can be adopted as part of the 'Effective engagement and sharing of best practice' criterion, in accordance with SLC 49.

- One DNO asked for further clarity as to whether steps to investigate, or implement, solutions related to the management of losses, which utilise outputs from work funded under other mechanisms (eg the Network Innovation Allowance), would be eligible for reward under the LDR if such actions were funded at the DNO's own expense.

The Guidance makes it clear that it is the responsibility of each DNO to verify that any processes or actions listed in their submissions are not funded under any other RIIO-ED1 financial initiatives. This is to ensure DNOs are not rewarded multiple times for the same activity.

- One DNO expressed concern that knowledge sharing between DNOs and other stakeholders is not incentivised strongly enough by the LDR.

One of the assessment criteria in the Guidance assesses how effectively DNOs are engaging with stakeholders (including one another) and sharing best practice. DNOs must provide an appropriate level of evidence under each assessment criterion to be eligible for any reward under the LDR. We believe this is a strong enough incentive on DNOs to implement effective processes in this area. As with the other assessment criteria, we will ensure any processes listed are robustly assessed during the assessment stage.

⁵ <https://www.ofgem.gov.uk/ofgem-publications/47068/riioed1decoutputsincentives.pdf>