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Chris Watts
RIIO Implementation Team, SG&G
The Office of Gas and Electricity Markets
9 Millbank
London
SW1P 3GE

Our ref	*Your ref*	*Date*
-		09 November 2015

Dear Chris,

Consultation on close out methodologies for the DPCR5 Price Control

I am writing on behalf of Western Power Distribution (South Wales) plc, Western Power Distribution (South West) plc, Western Power Distribution (East Midlands) plc and Western Power Distribution (West Midlands) plc in relation to Ofgem's consultation dated 29th September 2015, which covers proposed close out methodologies for the DPCR5 Price Control.

WPD has been engaged with the process of the development of these methodologies and will continue to support further discussions to refine them. Good progress has been made since the initial DNO meeting on 29 July 2015, but there are inconsistencies in the level of completeness across mechanisms and in some cases activities are specified without specific details of information requirements being provided.

We have raised concerns about the proposed 31 May 2016 deadline for submitting close-out data as this falls within the period for the preparation of ED1 Year 1 RIGs data tables and DPCR5 data resubmitted in ED1 reporting format. DNOs proposed delaying submission until December 2016 However Ofgem's preference is to request the data as soon as the changes to the Financial Handbook take effect in April 2016.

In order to bring the deadline forward, firstly as stated in paragraph 1.9 of the consultation, Ofgem's assessments under the methodologies should be based on data provided by the companies during 2010-15 under the DPCR5 RIGs. Ofgem should not request large volumes of additional data that has not been previously reported. Ofgem should also consider the volume of data required for the methodologies to ensure that the requirements remain proportionate with the analysis to be carried out and the materiality of any potential adjustments to allowances and revenues.

Secondly as per paragraph 1.9 Ofgem should specify any additional information requests as far as possible in advance. Any proposed workbooks to collect such additional data need to be issued for comment by end of December, with the final versions issued to DNOs at the same time as (but not necessarily as part of) The Financial Handbook Statutory Consultation in early February 2016.

If this is not possible then our preference is to submit close out data in December 2016; this would benefit both Ofgem and DNOs by moving data submission and analysis to a time of year where there is less regulatory reporting and analysis.

In appendix A, we highlight a number of general areas where further work or clarification is required.

In appendix B, we provide responses to the questions Ofgem posed throughout the consultation.

In appendix C, we point out a number of typos in the consultation that could impact understanding of the final methodology.

Should you wish to discuss any aspects of this submission please contact amichalowski@westernpower.co.uk or pmann@westernpower.co.uk.

Yours sincerely

ALISON SLEIGHTHOLM
Regulatory & Government Affairs Manager

Appendix A – General Areas of Further Work and Clarification

Avoidance of double adjustments

There is a possibility that adjustments could be applied for non-delivery of LI outputs and underspend against the load related reopener. There is also a possibility that adjustments could be applied for non-delivery of HVP outputs and underspend against the HVP reopener. Ofgem specify (in paras 3.15, 3.32, table 4.2, 4.37, A3.32) that processes will be in place to avoid double counting adjustments, but don't specify how this will be achieved.

Ofgem has previously circulated an email to the Close Out Working Group which included an 'interactions document' describing a proposed methodology for avoiding double adjustments. WPD responded to this email highlighting concerns that the document was confusing and unclear. In that response, WPD also proposed a two stage approach to avoid double adjustments. The initial stage would assess outputs to determine outputs non-delivery adjustments. The second stage would assess expenditure against re-opener thresholds. To avoid double counting, the outputs adjustment value would be used as a credit to expenditure when assessing expenditure adjustments. This would effectively treat the outputs adjustment as incurred expenditure thus avoiding the same value being deducted twice.

Further work is required to clearly specify how double adjustments will be avoided.

Avoidance of double benchmarking

The final proposals for DPCR5 were derived from benchmarking and included reductions to DNO revenues to drive DNOs to deliver at an efficient level. This means that the allowances set for DNOs included efficiency assumptions.

DNOs should therefore be assessed against the allowances and where these have been met DNOs should be judged to have delivered in line with the embedded efficiency assumptions.

Many of the close out mechanisms suggest further benchmarking work which may conclude that the current view of efficiency is at lower costs to those assumed in the allowances. This enhanced level of efficiency should not be used to claw back revenues from DNOs as they were not part of the 'regulatory deal' DNOs signed up to deliver.

This retrospective efficiency assessment also dilutes the strength of the DPCR5 IQI mechanism that is intended to reward DNOs for achieving efficiencies during the price control.

Exclusion of RPEs

In paras 1.10, 3.15, 4.15, A3.9, Ofgem states that the effect of RPEs will be discounted from any adjustments applied under the load-related re-opener or the HVP reopener, but does not provide further details on how this will be applied.

Financial Adjustments

Financial adjustments are only specified under HVP adjustments in para A4.36. We would expect similar adjustments to be specified for all mechanisms.

Determining Annual Values for Financial Adjustments

Step (i) of the financial adjustments specified in Para 4.36 states that annual values will be determined for the changes to expenditure allowances. There is no explanation provided how overall assessments using DPCR5 period values will be converted to annual values.

Inconsistent referencing to materiality test

In the DPCR5 Final Proposals, the materiality test was specified as being based upon 1% of base demand revenue in 2010-11 (Para 2.20 of Doc 148/09 Final Proposals – Financial Methodologies).

The consultation document describes the materiality test differently in a number of locations, referring to it as

- Base revenue
- Base demand revenue
- DPCR5 base demand revenue
- DPCR5 base revenue
- DPCR5 revenue allowance for Regulatory Year 2010/11.

All references should be the same and should reference 2010/11 base demand revenue.

This specifically applies to paragraphs 1.12, 3.7, 3.31, 4.6, 5.6, 4.33, A3.2, A3.28 A4.35, A5.27, footnote 19, footnote 20, footnote 24.

Appendix B – Responses to questions in the consultation

CHAPTER: Two - Network Output Measures

Question 1: Do you agree with the principles for the NOMs assessment?

We broadly agree with the principles, with the following exceptions / adjustments.

Principle 2 states that the delivered NOMs should be in line with, or better than, the agreed deliverables. DNOs were funded to deliver an agreed set of deliverables; therefore there should not be an expectation that these deliverables have been exceeded. Principle 2 should be limited to assessing that DNOs have broadly met the agreed deliverables.

Principle 5 states that decisions affecting the timing of interventions should be justified, where appropriate, through whole life Cost-Benefit analysis. There may be various reasons why timing is different, so we suggest that the principle remains broad for various different justifications, not just Cost-Benefit analysis.

Question 2: Do you agree with our approach to assessing performance on Health Indices?

We agree with the adoption of the risk points methodology for the assessment of performance on Health Indices.

Question 3: Which of the two approaches to valuing the Health Indices outputs gap do you consider to be more appropriate?

The detailed valuation is more consistent with the approach being taken for the calculation of risk points to determine whether an outputs gap exists.

Note that there is an inconsistency in the methodology documentation for which unit costs are used to value the outputs gap. Para 2.26 refers to the FP unit costs used in setting allowances, whereas A2.17 refers to the DPCR5 FBPQ unit costs (i.e. those proposed by the DNOs in the forecast business plans). The value should be based on what was allowed, not what was forecast. The references in para A2.17 need to be corrected.

The high level valuation provides a simplified approach, which could be used as a cross check of the more detailed approach.

Note that the process described needs to make it clearer that the expenditure is divided by the "risk points delta delivered" not "the total number of risk points delivered". This applies to para 2.26 and para A2.19 b).

Question 4: Do you agree with our approach to assessing performance on Load Indices and valuing any associated outputs gap?

We agree with the adoption of the risk point methodology alongside the LI profiles for the assessment of performance on Load Indices.

The use of LI risk points should be limited to analysis of individual substations because DNOs have populated substation groups differently: some DNOs have included all groups whereas others with more complex networks have only included those where work was proposed during DPCR5. This means that a network wide view of LI risk based on substation groups is not possible for those DNOs that have populated substation group data by exception.

The approach described in para 2.37 for valuing the LI NOMs gap is slightly different to that described in A2.34. Para 2.37 suggests that allowed expenditure is divided by the risk points to generate a £ per risk point value, but it is unclear what these risk points relate to. This wording should be revised to make it clear that the expenditure is divided by the difference in risk points between the forecast position at the end of DPCR5 with investment and the forecast position at the end of DPCR5 without investment.

Question 5: Do you agree with our approach to assessing fault rate performance?

Yes

Question 6: Do you agree with our proposal not to make any financial adjustments associated with fault rate performance?

Yes.

Although DNOs activities do influence fault rates, external influences (such as weather) can also influence them. This means that the results are not fully influenced by the activities of DNOs. Furthermore there are some asset categories covered by fault rate outputs where there are low volumes of activity and minor changes in fault volumes can lead to significant variances in fault rate.

Question 7: Do you agree with the changes we have made to the assessment approach from DPCR5 FPs and the NADPR RIGs?

The NADPR RIGs did contain various principles that should remain in place. This includes the principle that there should be a material and significant issue with the delivery of NOMs before it can be judged that a DNO has not delivered its NOM deliverables.

The proposed assessment approaches are more practical than those proposed in the NADPR RIGs. The original processes described in the NADPR RIGs were developed towards the end of the DPCR5 price control process and therefore were a best view at the time of how an assessment may be carried out. The proposed processes are based upon evolution of assessment mechanisms during DPCR5.

CHAPTER: Three - Load-related reopener

Question 1: Do you agree with the principles for the load-related reopener assessment?

We broadly agree with the principles, but draw Ofgem's attention to the following:

Principle 10 will consider the amount of connections reinforcement funded by customers. The amount that is charged to customers is derived from defined cost apportionment rules that take into account the amount of available capacity used by those customers. This means that the proportion funded by customers depends on customer requirements. The net to gross ratio is therefore mostly outside a DNO's control.

Question 2: Do you agree with our approach to assessing expenditure on low volume high cost (LVHC) connections?

The proposed process considers volumes and net to gross ratio.

In the response to question 1, we highlight that net to gross ratio is mostly outside a DNOs control and therefore mechanistic adjustments should be avoided.

It is not clear what data will be analysed from RIGs submissions. Para 3.24 suggests that a sample check will be made of outlier schemes implying that project specific data will be used. It should be noted that, in the RIGs submissions, project specific information is only provided for completed projects in table CN2 and for quotations in table CN9. These values will not reconcile to the in-year totals that include partially completed projects.

It is also unclear how any trade-off between connection reinforcement and general reinforcement will be identified and assessed.

Question 3: Do you agree with our approach to assessing expenditure on general reinforcement?

Para A3.6 suggests that the extent of narrative and supporting documentation should be proportionate to the degree of which actual expenditure is lower than thresholds. This implies that minimal information is required if DNOs are within expenditure thresholds. Para A3.9 suggests the contrary, where extensive assessment and justification is required to explain the expenditure incurred. Further guidance is required on what is expected depending on the level of DNOs actual expenditure.

The scope of what is included within the load-related reopener needs to be clearer. It should include general reinforcement for demand and generation, excluding reinforcement associated with specific DG connections. Paragraph 3.4 requires amendment to be clear that the DG incentive related to DG connections and that only this part of DG work is excluded from the load-related reopener. We suggest the addition of the word "connections" after "associated with distributed generation (DG)". This clarification should also be made in paragraph A3.1.

A number of the proposed assessments suggest that scheme level information is available. This includes:

- Para 3.28 & A3.20 checking a sample of investment schemes
- Para 3.28 review of unit costs
- Para A3.19 analysis at individual substation level for individual substations and substation groups

Scheme level information has not been provided as part of RIGs reporting submissions during DPCR5. Retrospective collation of information could be a significant paper trawl for those DNOs with high volumes of projects. This could be wasted effort, especially for DNOs that have exceeded expenditure thresholds.

Paragraph 3.27 refers to high level ratio analysis that compares the ratio of capacity added to the demand growth above firm capacity. The amount of demand growth is not relevant to the requirement to reinforce. A small amount of demand growth at one substation may require the same level of reinforcement as larger demand growth at another substation. Once reinforcement is required, the amount of capacity is determined by other substation factors and standard transformer sizes. This assessment should not lead to mechanistic adjustments.

Question 4: Do you agree with our approach to assessing avoided reinforcement?

Yes.

The onus should be on DNOs to demonstrate that the use of DSM and innovative techniques has led to avoided reinforcement. Since many innovative schemes were still under-development in DPCR5, there should be a limited number of occasions where such evidence is required.

Question 5: For non-DNO interested parties, do you have any evidence you can provide that would support our assessment of the load-related reopener?

N/A

CHAPTER: Four - High Value Projects

Question 1: Do you agree with the principles and general approach set out in this chapter?

We agree with the methodology, but draw Ofgem's attention to the following:

The interaction between outputs non-delivery and expenditure re-opener needs to be defined, because where outputs are not delivered there is a high likelihood of expenditure falling below thresholds.

The first bullet in para 4.27 suggests that where a project is not delivered, the full value will be recovered. There may be situations where investigative works and pre-project costs have been incurred (in good faith). Ofgem should assess these costs and where they are valid they should be netted off the full amount when determining adjustments.

Question 2: Do you agree with the changes we have made to the assessment approach from DPCR5 FPs?

Yes.

The changes mainly develop processes where the DPCR5 final proposal did not provide details.

Question 3: Do you have any suggestions on how we can assess outputs under the individual project categories set out in this document?

Reinforcement

HVPs for reinforcement work will mainly relate to complex situations where LIs do not provide sufficient explanation of the drivers. For example LIs only consider n-1 situations and HVPs could be associated with n-2 situations across different grid supply points.

This means that a project by project assessment is more relevant to determine whether the outputs were achieved.

The determination of outputs at the start of DPCR5 was undefined and DNOs provided some information in response to supplementary questions. Some of these details may not adequately capture the outputs being delivered for customers, so DNOs should be given the opportunity to clarify the outputs with reference to previous submissions.

The assessment should determine whether the solutions delivered provide the network capacity/alleviate a network constraint in line with the outputs.

Asset Replacement

HVPs for asset replacement should use the same methodology as used for HI NOMs.

BT21CN

DNOs have proposed and implemented different solutions to provide the same functionality as dedicated BT communication lines. These solutions may be based upon one technology type or a combination of types. The technology chosen could be influenced by existing communication architecture or geographical considerations. Furthermore, solutions may use multiple communication 'hops' on different technologies or a direct route using a single technology.

The wide mix of approaches will make disaggregated benchmarking difficult. Any high level benchmarking would need to take account of the differences in DNO approaches and hence a median cost would be more appropriate than a quartile cost.

It may be more appropriate to qualitatively assess each DNO's strategy, adoption of solutions and programme delivery against the original plan to determine whether outputs have been met and/or more efficient solutions adopted.

Legal and Safety

It is understood that only one project exists in this category and it is related to tree clearance. There should be sufficient data available in RIGs submissions and previous DPCR5 and RIIO-ED1 benchmarking to assess whether the tree clearance has been delivered efficiently.

Question 4: For non-DNO interested parties, do you have any evidence that would help with our assessment of HVPs?

n/a

CHAPTER: Five - Traffic Management Act

Question 1: Do you agree with our proposed methodology for adjusting DNOs' allowances to account for permitting costs?

We agree with the methodology, but draw Ofgem's attention to the following:

Principle 3 states that all permitting costs are subject to an efficiency assessment. Since some of the costs are determined by local authorities, only those under the control of DNOs should be included in the efficiency assessment.

Para 5.22 is unclear on what is being adjusted when efficient costs exceed the materiality threshold. It states "we intend to make an adjustment to that efficient amount". The adjustment should be made to allowances not the efficient costs. This clarification should also be made in para A5.28.

Question 2: For wider stakeholders non-DNO interested parties – Do you have any information or evidence which would assist us in carrying out the TMA reopener assessment?

n/a

Question 3: Do you agree with our proposal to settle the TMA reopener mechanism early as part of the 2016 annual iteration?

No.

The timescales for the provision of data are impractical.

Para 5.12 suggests that Ofgem will ask other DNOs and GDNs to provide data by 31 May 2016 to allow for a comparative analysis, but Ofgem will not know whether DNOs will be triggering the TMA reopener until 31 April 2016. This means that there will be a maximum of a month for DNOs to provide historic data, at the same time as DNOs will be populating the first year of RIIO-ED1 RIGs requirements.

A submission of data at the end of September 2016 (or even later) would be more practical. This would still allow Ofgem sufficient time to carry out analysis and determine provision adjustments by August 2017, as originally proposed in the financial handbook.

Appendix C – Typos that impact the methodologies

A2.4 third bullet
This currently states "If the DNO has delivered a worse HI profile than agreed at DPCR5 or the number of risk points is higher…". It should be "If the DNO has delivered a worse HI profile than agreed at DPCR5 or the risk point delta is lower…".

A2.10
Point b) is superfluous. Review the other referencing once removed.

A4.22
"principles" in third row should be "criteria".

A4.25
"principles" in third row should be "criteria".