Lloyds Court
78 Grey Street
Newcastle Upon Tyne
NE1 6AF

Chris Watts
RIIO Implementation Team, SG&G
Ofgem
9 Millbank
London
SW1P 3GE

9 November 2015

Dear Chris

Consultation on close out methodologies for the DPCR5 price control (the Consultation)

1. Thank you for the opportunity to respond to the above consultation. Our detailed response to each of the questions is set out in the annex below, but I also wanted to draw your attention to the key points. These relate to the benefits that simplicity can bring to the overall process, the use of disaggregated benchmarking, the proposed principles, and the treatment of efficiencies through innovative techniques.

The value of simplicity

2. In relation to the financial reopeners, some complex approaches are proposed to decomposing variances between allowances and actual expenditure.
3. But at their heart the reopeners are simple. Ofgem just needs to:
    a. start with actual expenditure;
    b. deduct any inefficiently incurred costs;
    c. add back any efficiencies due to efficient demand side management techniques;
    d. Adjust the baseline so it is stated on the same basis as actual expenditure;[1]
    e. Compare the efficient actual expenditure with the adjusted baseline, applying the threshold and materiality tests.
4. If Ofgem adopts this simple approach it will not only be true to the DPCR5 *Final proposals*; it will also free up time for considering other issues more deeply, where greater value can be achieved.

Disaggregated benchmarking

5. In a number of areas the proposed efficiency and asset index gap analysis assessment would make use of quantitative, relatively mechanistic, benchmarking techniques.
6. As I know you already recognise, disaggregated benchmarking analysis suffers the weakness that differences in costs across companies may not be driven by genuine differences in efficiency. For example, they can instead by driven by:

[1] I.e. including the allowance for ongoing efficiency gains, and with RPEs adjusted to the level measured in the DPCR5 period (rather than the level forecast at the DPCR5 review)

a. Imperfections in the available ***cost drivers***;

b. Different ***business models*** (e.g. insourced or outsourced); or

c. Different approaches to ***cost allocation*** (where not prevented by reporting rules).

7. When setting allowances at a price control review, Ofgem uses totex benchmarking to balance some of these problems. The company also has the opportunity to review its business model in light of the benchmarks implicit in the price control, and (if warranted) adjust its approach. If the allowances are genuinely too low, it can appeal its price control settlement to the Competition and Markets Authority.

8. But these checks and balances are not present in the reopener, since totex benchmarking cannot be applied to the relevant sub-categories, since actual costs have already been incurred (precluding any business model changes) and since appeal mechanisms in relation to the reopener outcome may be limited. Any imperfections in the benchmarking will ***necessarily*** lead to stranded costs even where no inefficiency has occurred. The ex post reopeners are therefore fundamentally different from price control reviews when it comes to benchmarking.

9. For these reasons, the mitigating approaches proposed by Ofgem are important. These include the use of median benchmark, rather than upper quartile, the opportunity to justify qualitative adjustments to the inputs, and additional supplementary qualitative assessments. We support these aspects of the assessment and they should be adopted in the final methodology.

<u>The proposed principles</u>

10. In relation to the principles, some go beyond what was set out in the DPCR5 *Final proposals*, or introduce complexity that is not necessary. Where this is the case, and absent good reasons to the contrary, they should be pared back. This will help make the assessment as closely aligned to the DPCR5 *Final proposals*, and as simple, as is possible. We have provided detailed feedback on all the principles in our response to the Consultation questions, in the annex.

11. That said, an additional element to principle 2 in relation to the efficiency assessment of load related expenditure and high value project costs would bring benefits by enhancing investor certainty over investment decisions, and align with good regulatory practice. This additional element should say that '*Ofgem will adjust DNO actual expenditure only where there is robust evidence that the actual expenditure was inefficient, and will assess DNO decisions and costs to have been inefficient based on the information which was (or should have been) available at the time the decision was taken – i.e. the benefit of hindsight will not be used*'. [2]

<u>The treatment of efficiencies achieved through 'innovation'</u>

12. The DPCR5 *Final proposals* included a promise to 'offset' any expenditure avoided through demand side management techniques.

13. The Consultation appears to broaden the list of activities which can qualify for such treatment, to include any 'innovative activities to avoid general reinforcement or LVHC connections expenditure', giving examples which include 'energy storage' and the much broader 'smart grid solutions'.

14. While we believe this to be a broadening of the definition relative to the DPCR5 *Final proposals* the change is not highlighted in the relevant section of the Consultation. Moreover, since the broadening of definition is taking place after the DPCR5 period has finished, it is not clear that it can affect incentives or behaviour.

15. Putting what is to be included to one side, it is important that Ofgem ensures it has robust evidence of inefficiency in any costs actually incurred by companies. The Competition and

[2] While we agree that DNOs should bring forward robust evidence of efficiency, to allow Ofgem to focus its attentions on other areas, any perceived weakness in this evidence is not the same thing as evidence of inefficiency. It is crucial to regulatory certainty that Ofgem has robust evidence of inefficiency before it disallows actual costs.

Markets Authority has highlighted that the benchmarking of ‘non-costs’ can be especially problematical, and that definitional problems can be severe. Benchmarking and read across of the savings evidenced by DNOs should therefore be avoided.

16. Moreover, if Ofgem finds that some companies have significantly reduced their costs through ‘innovation’ (however broadly defined), it should also consider ‘adding back’ these costs into the dataset used for any quantitative benchmarking of actual costs. The innovative techniques may not be replicable on other networks in different scenarios, and if Ofgem considers they have had a material impact on cost, it should avoid reading this across to other networks.

Next steps

17. The methodologies are taking shape and we expect to contribute further to their development. In particular, we have not yet provided detailed comment on the draft text for the financial handbook. We expect to do so via the licence drafting working group which Ofgem has tasked with taking forward the drafting.

Yours sincerely

Keith Noble-Nesbitt

Keith Noble-Nesbitt
Head of Regulatory Economics

ANNEX – RESPONSES TO QUESTIONS

1. The answers to the questions below, and the covering letter above, are the response from Northern Powergrid (Northeast) Ltd and Northern Powergrid (Yorkshire) Plc to Ofgem's consultation entitled *Consultation on close out methodologies for the DPCR5 price control* (the Consultation).

NETWORK OUTPUT MEASURES

Chapter 2, Question 1: Do you agree with the principles for the NOMs assessment?

18. Ofgem has described six principles in the consultation on which we have the following observations:
    a. ***Principle 1:*** We agree that DNOs and customers should share in the benefits obtained from genuine efficiency improvements.
    b. ***Principle 2:*** The NOMs framework should allow DNOs to make the correct asset management decisions in the interests of customers. There will inevitability have been changes to the DNOs' planned investment programme over DPCR5 but we agree that overall the investment programme should have delivered at least the same level of risk reduction as the DPCR5 Agreed Outputs.
    c. ***Principle 3:*** We agree that the NOMs deliverables should be assessed at an overall level as opposed to a line by line basis. The supporting level of evidence should be proportionate to delivery performance and the level of information provided through annual cost reporting.
    d. ***Principle 4:*** We agree that the performance assessment should not discourage improvements or innovations.
    e. ***Principle 5:*** Justification for changes to asset management strategy should be supported by an appropriate level of analysis rather than the use of an Ofgem CBA template that was only developed during the ED1 process. We believe that changes to asset management strategy during DPCR5 by DNOs should be consistent with that demonstrated in their ED1 business plan submissions or differences should be explained.
    f. ***Principle 6:*** We agree that there must be significant and material issues at an overall level with NOM delivery before it can be determined that a DNO has not met its deliverables.
19. There is an element of subjectivity with regards to the length of the performance assessment documentation required for submission by DNOs. It is in the interests of both DNOs and Ofgem for this submission to be as effective and efficient as possible. Therefore we would welcome more detailed guidance from Ofgem on a bilateral basis.

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

20. We agree with the three stage process outlined by Ofgem.
21. The first stage should have consideration to the material changes logged with Ofgem through the DPCR5 annual reporting process. The DPCR5 Network Asset Data and Performance Reporting (NADPR) RIGs stated that Ofgem would review the annual submission, have a substantive discussion with the DNOs and provide its opinion on progress. Ofgem should therefore not use inappropriate hindsight in the assessment of material changes reported over the DPCR5 period.
22. We believe that the updating of new condition data from more recent asset inspections or maintenance has been reported differently by DNOs. Some have reported these as a material

change whilst others reported the same type of data updates as movements due to deterioration. Additional guidance may have been provided by Ofgem over DPCR5 to some DNOs and not others. This is disappointing considering the information provided by DNOs in the material change logs, since the logs would have made clear the approach taken by different DNOs.

23. The DPCR5 *Final proposals* stated that *"further improvement and innovation in asset management techniques should be encouraged not hindered by the performance assessment process"*.[3] Therefore where material changes have arisen from DNOs acting on the latest condition data or through the development of asset management techniques they should not be penalised.

24. The stage 1 detailed methodology in Appendix 2 of the consultation appears to be at odds with section 2 of the Consultation and the DPCR5 *Final proposals*. The deliverable for the DPCR5 period was the delta between agreed HI profiles, with and without intervention, at the end of the period. The detailed methodology appears to indicate that the deliverable was a specific HI profile as opposed to a delta. It also looks like some inadvertent formatting in that section requires all DNOs to provide excessive amounts of information on why assets have not been replaced, regardless of whether they have delivered their delta. The information provided should be proportionate.

25. In doing any comparison between DNOs on delivery performance Ofgem should be careful of differences between DNOs in their health index methodologies, for example differences in health index band mappings leading to a perception of more value being delivered, when in fact this may just be caused by one DNO placing an asset in a higher banding when compared to another DNO facing the same condition asset.

26. As Ofgem performs its detailed assessment as part of stage 2 the following aspects need to be included:

    a. Rows in the health index tracking spreadsheets show the total net movements in health index bands that are the summation of additions and removals from individual projects or programmes of work. This will affect reconciliation analysis.

    b. Reconciliation analysis needs to be done against additions and removals as well as CV3 and CV5 in the Cost and Volume RIGs.

    c. Unit costs used in the hybrid voltage categories such as HV and EHV need to be reflective of the work mix due to the difference in costs between 11kV to 20kV and 33kV to 66kV equipment.

Chapter 2, Question 3: Which of the two approaches to valuing the Health Indices outputs gap do you consider to be more appropriate?

27. The second of the two options for valuing the outputs gap is more appropriate for valuing the output delivered by the portfolio of work. This is because it recognises that targets were not set at a disaggregated level for each asset type and that we should deliver the investment that produces the most value for customers overall.

Chapter 2, Question 4: Do you agree with our approach to assessing performance on Load Indices and valuing any associated outputs gap?

28. We agree with the three stage process outlined by Ofgem.

29. During stage 1, the level of supporting analysis provided by the DNO needs to be proportionate. For example if a decision was taken not to reinforce due to low load growth compared to that

[3] DPCR5 Final proposals, incentives and obligations document, page 103, para 19.24

originally forecast, the provision of a CBA to provide justification would be inappropriate. We assume that the analysis provided by DNOs would also cover the requirements of the load related reopener as well.

30. When Ofgem performs the stage 2 assessment it may not appropriate to use a single form of load index weighting. This is because the logic used for load indices was different between DNOs for DPCR5. We suggest that any increase in the band weighting from a default value of 1 should occur when a substation starts to become over 100% of firm capacity.

Chapter 2, Question 5: Do you agree with our approach to assessing fault rate performance?

31. We do not agree with the proposal in paragraph 2.39 to use a risk point methodology to assess performance, although we understand this may simply reflect a drafting inconsistency. The proposal is also inconsistent with the fault rate methodology described in Appendix 2 of the Consultation with which we do agree.

32. We agree that a DNO should submit a performance assessment that details the trends in fault rate performance over the DPCR5 period. We believe that this analysis should be in the spirit of the annual Medium Term Performance Reports compiled by DNOs for Ofgem over the DPCR4 period. Therefore consideration should be given to movements in fault causes such as third party interference, weather, and asset deterioration etc. Explanations for damage and non-damage fault trends should be provided.

Chapter 2, Question 6: Do you agree with our proposal not to make any financial adjustments associated with fault rate performance?

33. As fault rate performance seen by customers is inherently part of the interruptions incentive scheme (IIS) we agree that no further financial adjustments are necessary. We also agree because no additional financial adjustment (beyond IIS) was signalled in the DPCR5 *Final proposals*.

Chapter 2, Question 7: Do you agree with the changes we have made to the assessment approach from DPCR5 FPs and the NADPR RIGs?

34. Ofgem has referenced four changes in table 2.1 of the Consultation. We agree with three of those changes but disagree with the proposal not to account for material changes in the health index performance assessment. We note that the view expressed by Ofgem at a working group meeting on 19 October was different from that written in the Consultation so we look forward to gaining more clarity from Ofgem on its intent.

35. On this particular point, we agree that the total value of the risk delta signed up to by DNOs as part of the DPCR5 *Final Proposals* should not change. However the underlying health index profile before intervention has changed over the DPCR5 period as the result of material changes reported on an annual basis by DNOs in accordance with the NADPR RIGs. Material changes can be entirely valid, and in fact are necessary in order to efficiently manage an asset base. But Ofgem should consider whether the extent and net direction of material changes may have made it easier for a DNO to achieve a particular level of risk delta. If it has, then the material changes themselves may warrant closer evaluation as part of the NOMs assessment.

LOAD RELATED EXPENDITURE

Chapter 3, Question 1: Do you agree with the principles for the load-related reopener assessment?

36. We agree with and support with principles 4, 5, 6, and 9.

37. As set out in the covering letter to this response, there should be an additional element to principle 2, to help ensure that investor certainty over investment decisions is protected. This additional element should say that '*Ofgem will adjust DNO actual expenditure only where*

there is robust evidence that the actual expenditure was inefficient, and will assess DNO decisions and costs were inefficient based on the information which was (or should have been) available at the time the decision was taken - i.e. the benefit of hindsight will not be used'.

38. As a general point, the principles should not depart from the mechanics of the reopener mechanism set out in the DPCR5 *Final proposals*, or add overly to the complexity of the assessment. Some of the principles do however appear to do so, and so should be amended (or removed if not required).[4] These principles, and our observations, are as follows.

    a. ***Principle 1:*** This principle partly relates to the non-delivery of outputs. The load related reopener does not relate to delivery of outputs (since this is covered by the outputs delivery mechanism). Therefore, although principle 1 should apply in the context of the network outputs mechanism, it should not only apply to the load related reopener. The load related reopener tests whether efficient expenditure has fallen outside set financial bands, and if it has then the reopener is activated.

    b. ***Principle 3:*** The need for evidence to support expenditure avoided through innovative solutions is covered by principle 7. There is no need for additional justification for expenditure avoided by other means since this would add complexity to the evaluation of the reopener thresholds, and is not necessary based on the description of the reopener in the DPCR5 *Final proposals*.

    c. ***Principle 7:*** the DPCR5 *Final Proposals* stated that Ofgem would give credit for costs avoided using demand side management techniques. The principle as now stated broadens this significantly to include *any* innovative activities.

    d. ***Principle 8***: The load related reopener as set out in the DPCR5 *Final proposals* did not suggest that there would be an assessment of offsetting delivery efficiencies (excluding innovative approaches such as demand side management). Such an assessment could be challenging - for example, different types of delivery efficiencies may be easier to quantify than others. But Ofgem could nevertheless avoid discouraging delivery efficiencies by avoiding benchmarking techniques that involve ratchets to the lower of company actuals or the benchmark.

    e. ***Principle 10***: The DPCR5 *Final proposals* stated that Ofgem may consider it inefficient if DNOs 'under-recovered' their high-cost connection charges from the connectees.[5] Provided a DNO has not 'under-recovered' there should be no finding of inefficiency, and no impact on the reopener assessment. Yet the principle says that Ofgem wishes to 'ensure DNOs do not benefit through the efficiency incentives from changes in net costs that have been funded through connection charges'. This was not foreshadowed in the DPCR5 *Final proposals*. The principle should therefore be rephrased 'where DNOs have under-recovered the charges they should have levied on connecting customers, we will consider whether this may represent inefficiency'.

    f. ***Principle 11***: The principle should be stated as described in the DPCR5 *Final proposals*, which is that DNOs will retain the risk associated with real price effects. This requires that both the baseline used for assessing the reopener threshold and the actual expenditure should be on an equivalent footing (e.g. both including ongoing efficiency, but the RPEs evaluated at the level actually experienced, rather than the level forecast at DPCR5). This should be done before the evaluation of the reopener thresholds, and

[4] Many of these departures are not highlighted in the section of the Consultation which comments on sets out changes since the DPCR5 *Final proposals*

[5] DPCR5 Final proposals, financial methodologies document, page 11, para 2.3. Given it is the design requirements of the customer that determines the proportion of costs allocated to a connectee, we do not believe a lower share paid for by connectees is likely to represent under-recovery or inefficiency. However, if DNOs incurred bad debts associated with non-payment of connection costs it incurred, then it is possible these costs might have been inefficiently incurred.

the calculation of any true up necessary, in order that DNOs retain that risk associated with RPEs.[6]

Chapter 3, Question 2: Do you agree with our approach to assessing expenditure on low volume high cost (LVHC) connections?

39. As a general point, we agree with the 3 stage process for the overall assessment, although we note that actuals and baselines should be placed on an equivalent basis at the outset to avoid apples and pears comparisons (and ensure the risk associated with RPEs remains with DNOs). This may warrant an additional stage, or could be incorporated as part of stage 3.

40. Specifically in relation to high-cost connections, and as noted above, the efficiency test on connection charges should be limited to the item mentioned in the DPCR5 *Final proposals*, i.e. whether the DNO has failed to recover charges it should have recovered from connecting customers. The movement in costs that arises because of the volume of connections and proportion of costs that should be allocated to connectees (i.e. the net to gross ratio) is not an efficiency test (para A3.14 and A3.17 in Appendix 3) and should be deleted. This is more correctly considered in the Stage 1 performance assessment as already stated at paragraph A3.8.

41. During stage 1, the level of supporting analysis provided by the DNO needs to be proportionate, for example if the DNO is within the two financial deadbands it is less likely to trigger the reopener than a DNO outside the bands, and so should need to provide less justification. This need not preclude DNOs from providing further justification at a later stage if Ofgem's efficiency assessment process raises questions for that DNO.

42. In terms of the detailed assessment, we note that Ofgem proposes to benchmark DNO LVHC costs using the industry median at a disaggregated level. As a general rule, disaggregated benchmarking analysis suffers the weakness that differences in costs across companies may not be driven by genuine differences in efficiency. For example, they can instead by driven by:

    a. Imperfections in the available ***cost drivers***;

    b. Different ***business models*** (e.g. insourced or outsourced) or by

    c. Different approaches to ***cost allocation*** (where not prevented by reporting rules).

43. We do however note that Ofgem has proposed that any benchmarking would use the industry median to set the benchmark, and that this benchmarking would be used to identify outlier schemes for a qualitative review, with adjustments only being made depending on the results.

44. The overall approach, and the requirement for a qualitative review, therefore appears to address some the potential distortions that could be caused by applying a disaggregated benchmark to only one cost category, in isolation of the other categories of cost covered by the price control.

45. But it is still important that Ofgem should ensure it has robust evidence of inefficiency before it adjusts actual expenditure for the purposes of applying the reopener. The benchmarking will highlight areas for Ofgem to consider, but it is unlikely to give a definitive answer as to what the level of efficient costs should have been. Any imperfections in the benchmarking will ***necessarily*** lead to stranded costs even where no inefficiency has occurred. The ex post reopeners must recognise this fundamental difference in circumstances compared to those in place at ex ante price control reviews.

[6] This will require some adjustments to the baselines set out in the DPCR5 *Final proposals*. These baselines were pre-real price effects (RPEs) and pre- ongoing efficiency. In other words, absent RPEs, Ofgem expected DNOs to spend less than the baseline when the price control was set, and the allowances reflected this expectation. This oversight can now be corrected for evaluation of the reopener thresholds during the close-out.

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

46. As a general point, we agree with the 3 stage process for the overall assessment, although we note that actuals and baselines should be placed on an equivalent basis at the outset to avoid apples and pears comparisons (and ensure the risk associated with RPEs remains with DNOs). This may warrant an additional stage, or could be incorporated as part of stage 3.

47. In terms of the details of the proposed approach, we note that the Consultation places emphasis on quantitative as well as qualitative means of assessing disaggregated expenditure. This leads to some challenges:

    a. Any disaggregated assessment (whether of cost categories, or of unit costs), will suffer from the issues highlighted in the covering letter and paragraph 42 above.

    b. The available quantitative approaches for assessing load related expenditure at voltages above HV necessarily involve significant approximations to the actual cost drivers faced by companies.

    c. There is no reliable quantitative approach to assessing LV or HV load related expenditure, or for LVHC connection costs.[7]

48. For these reasons, Ofgem's proposed qualitative assessment, at paragraph A3.20 of the draft methodology, will be important to mitigate the risk that expenditure could be found to be inefficient through quantitative assessment, since the quantitative results alone may not be sufficiently robust to support a conclusion of inefficiency. Moreover, we support Ofgem's proposal to make qualitative adjustments where individual schemes justify higher costs.

49. Lastly, we are not sure that the variance analysis proposed at paragraph A.321 is necessary. To operate the reopener, Ofgem does not need to understand all the individual drivers of an under/overspend, just whether or not one occurred (and the extent to which the use of innovative techniques have affected costs). As set out in the covering letter, by simplifying the proposed approach, Ofgem can free up time and resources to consider other issues in more detail, where more value might be added.

Chapter 3, Question 4: Do you agree with our approach to assessing avoided reinforcement?

50. Broadly speaking, we agree with the proposed approach.

51. Our only comment relates to the scope of the assessment. The DPCR5 *Final proposals* promised that any reinforcement expenditure avoided by demand side management (DSM) techniques would be added to the amount used in the calculation of whether a reopener threshold is met.[8] The Consultation however appears to broaden the scope, to include any innovation (although the change is not highlighted in the relevant section of the Consultation). Moreover, since the broadening of definition is taking place after the DPCR5 period has finished, it is not clear that it can affect incentives or behaviour.

52. Whether or not a change in scope is warranted, it is important that Ofgem ensures it has robust evidence of inefficiency in any costs actually incurred by companies before removing those costs from assessment of the financial thresholds. The Competition and Markets Authority has highlighted that the benchmarking of 'non-costs' can be especially problematical, and that definitional problems can be severe.[9] Moreover, if Ofgem finds that some companies have

[7] In light of this we would propose deleting the word 'quantitative' from paragraph A3.23.

[8] DPCR5 Final Proposals, financial methodologies document, page 11, paragraph 2.3

[9] CMA, September 2015, Northern Powergrid (Northeast) Limited and Northern Powergrid (Yorkshire) plc v the Gas and Electricity Markets Authority, Final Determination, Conclusions on appeal ground 1, pages 68-69, para 4.128, and page 72, para 4.144

significantly reduced their costs through 'innovation' (however broadly defined), it should also consider 'adding back' these costs into the dataset before any quantitative benchmarking checks using actual costs to set the benchmark. The innovative techniques may not be replicable on other networks in different scenarios, and if Ofgem considers they have had a material impact on cost, it should avoid reading this across to other networks.

Chapter 3, 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?

53. This question is not applicable to Northern Powegrid.

HIGH VALUE PROJECTS

Chapter 4, Question 1: Do you agree with the principles and general approach set out in this chapter?

54. We agree with and support with principles 1, 4, 5, and 8.
55. As set out in the covering letter to this response, principle 2 should be broadened in order and ensure that investor certainty over investment decisions is protected. This additional content for the principle should establish that '*Ofgem will adjust DNO actual expenditure only where there is robust evidence that the actual expenditure was inefficient, and will assess whether DNO decisions and costs were inefficient based on the information which was (or should have been) available at the time the decision was taken - i.e. the benefit of hindsight will not be used*'.
56. There should also be an additional principle that high value projects will be assessed over the entire project (where this straddles multiple price control periods), so that the full financial cost, allowances, and output delivery can be taken into account.
57. As a general point, the principles should not depart from the mechanics of the reopener mechanism set out in the DPCR5 *Final proposals*, or add overly to the complexity of the assessment. Some of the principles do however appear to do so, and so should be amended (or removed if not required). These principles, and our reasons, are as follows.
    a. ***Principle 3:*** The need for evidence to support expenditure avoided through innovative solutions is covered by principle 6. There is no need for additional justification for expenditure avoided by other means. Under the DPCR5 *Final proposals* it is the actual expenditure which is relevant to evaluation of the reopener thresholds (adjusted for innovative cost saving techniques).
    b. ***Principle 6***: The high value project reopener as set out in the DPCR5 *Final proposals* did not suggest that there would be an assessment of offsetting delivery efficiencies (except whether achieved through demand side management). Such an assessment could be challenging - for example, different types of delivery efficiencies may be easier to quantify than others. But Ofgem could nevertheless avoid discouraging delivery efficiencies by avoiding any assessment of the individual components of a high value project that uses ratchets to the lower of company actuals or the benchmark.
    c. ***Principle 7:*** the DPCR5 *Final Proposals* stated that Ofgem would give credit for costs avoided using demand side management techniques. The principle as stated broadens this significantly to include *any* innovative activities.
    d. ***Principle 9***: The principle should be stated as described in the DPCR5 *Final proposals*, which is that DNOs will retain the risk associated with real price effects. This requires that both the reopener threshold and the actual expenditure be placed on an equivalent level of RPEs (e.g. zero RPEs). This should be done before the evaluation of

the reopener thresholds, and the calculation of any true up necessary, in order that DNOs retain that risk. [10]

Chapter 4, Question 2: Do you agree with the changes we have made to the assessment approach from DPCR5 FPs?

58. We agree that it is important that there should be no double counting between the high value projects financial reopener and the outputs delivery reopener.
59. We agree that it is important to recognise that projects can be at different stages of delivery. High value projects are often complex and can depend heavily on other parties rather than the DNO, therefore this should be recognised in any assessment.
60. Bespoke outputs assessment will be necessary for those projects without any existing generic methodology (such as HI).

Chapter 4, Question 3: Do you have any suggestions on how we can assess outputs under the individual project categories set out in this document?

61. In terms of the categories set out in the document, projects which were ongoing at the end of the DPCR5 period will present particular challenges. Both output delivery, and the financial reopener thresholds, should be tested both on the basis of within DPCR5 period performance, and on the basis of performance of the project over its full life. This sensitivity testing will help Ofgem avoid taking decisions which do not reflect the complete picture. This represents a development on the statement at paragraph 4.28 of the Consultation, which only mentions assessment of the DPCR5 period (without mentioning sensitivity analysis to take into account other periods).

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

62. This question is not applicable to Northern Powegrid.

TRAFFIC MANAGEMENT ACT COSTS

Chapter 5, Question 1: Do you agree with our proposed methodology for adjusting DNOs' allowances to account for permitting costs?

63. Northern Powergrid is not triggering the traffic management act reopener and so will not be affected by the proposed methodology.
64. We do however note that Ofgem is proposing to use an industry upper quartile benchmark cost in its assessment. As set out in the covering letter, disaggregated benchmarking results can be affected by different business models or cost allocation rules and can therefore lead to an inappropriate benchmark.
65. Ofgem should therefore consider supplementing its quantitative assessment from benchmarking with other sources of information, where available, to ensure that any finding of inefficiency is supported by robust evidence.

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[10] This will require some adjustments to the baselines set out in the DPCR5 *Final proposals*. These baselines were pre-real price effects (RPEs) and pre- ongoing efficiency. In other words, absent RPEs, Ofgem expected DNOs to spend less than the baseline when the price control was set, and the allowances reflected this expectation. This oversight can now be corrected for evaluation of the reopener thresholds during the close-out.

Chapter 5, Question 2: For wider stakeholders and non-DNO interested parties – Do you have any information or evidence which would assist us in carrying out the TMA reopener assessment?

66. This question is not applicable to Northern Powergrid.

Chapter 5, Question 3: Do you agree with our proposal to settle the TMA reopener mechanism early as part of the 2016 annual iteration?

67. We have no comments on, or concerns with, this proposal.