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Dear Chris

DPCR5 Closeout Methodologies - further changes since informal consultation

Thank you for the opportunity to respond to the above letter dated 2 December 2015. This letter should be treated as a consolidated response on behalf of UK Power Networks' three licensed distribution network operators (DNOs): Eastern Power Networks plc, London Power Networks plc, and South Eastern Power Networks plc. Our response is not confidential and can be published on your website.

With respect to the two specific changes mentioned in the letter we have the following responses:

- **Fault rates:** Your letter states that, following discussions with stakeholders, a methodology is now available to monetise fault rates. This methodology has not yet been made available to us which limits our ability to provide a considered response. However we would like to note the following general points:
 - **Materiality:** Fault rates are inherently volatile and this is particularly true when assessed over short periods of time and disaggregated into asset categories. Any methodology would have to take account of this including a materiality test that ensures only statistically significant differences are monetised.
 - **Interaction with other incentives:** DNOs bear the cost of responding to faults within a fixed allowance set at the beginning of the price control. Any increase in fault rates will lead to an increase in the DNO's fault costs which acts as an incentive for DNOs to manage fault rates in an economic fashion. Furthermore, throughout the DPCR5 period fault rates were effectively monetised through the IIS. If a DNO had allowed assets to deteriorate materially, they would be penalised through the associated Customer Interruptions (CIs) and consequent Customer Minutes Lost (CMLs) that occur when assets fail which were not factored into their original targets for DPCR5.

With this in mind, a fault rate adjustment should only be applied where:

- Other incentives have not acted to influence DNO behaviour,
- There is clear evidence that a DNO could have made rational economic decisions to influence the fault rate *and*
- The difference in fault rate is large enough to be considered statistically significant.

Any adjustment which satisfies these requirements should only be applied to relevant expenditure i.e. non-load expenditure associated with asset categories to which a Health Index is not applied.

Given your stated desire to modify the PCFM handbook to incorporate the DPCR5 closeout methodologies by 31st March 2016, UK Power Networks would welcome the opportunity to review the proposed methodology referred to in the decision letter. We are committed to working with Ofgem and other stakeholders to help develop an appropriate methodology suitable for the data on which it operates.

- **Material changes:** Appropriate methods to quantify and assess the impact of material changes are still the subject of ongoing discussion as part of the DPCR5 Closeout Methodologies Policy Working Group. UK Power Networks will continue to help develop these methodologies which should address the following points:
 - **New asset information during the price control period:** It is expected that DNOs will continue to improve both their asset management approach and the data which informs it throughout price control periods. These improvements allow DNOs to make better decisions and focus investment more effectively than would have been possible without these improvements. Any adjustments made should not discourage DNOs to continue to invest in improved asset management systems and data collection.
 - **Retrospective adjustment to Network Output Measures post price control period:** DNOs have made changes to their work programmes within the DPCR5 period to efficiently deliver the agreed Network Output Measures based on the framework that was in place at the time these decisions were made. Retrospectively making adjustments to the Network Output Measures does not allow DNOs the chance to act on the changes and ensure delivery of the agreed output measure target within the price control period.

UK Power Networks will continue to work with Ofgem, the other DNOs and other stakeholders to develop appropriate DPCR5 closeout methodologies through the Policy Working Group and hope that this response supports the process. If you have any questions specific to this response please do not hesitate to contact me.

Yours sincerely



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UK Power Networks

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