

Chris Watts
Senior Adviser – RIIO Price Controls
Smarter Grids and Governance
Ofgem
9 Millbank
London
SW1P 3GE

Electricity North West
Hartington Road, Preston,
Lancashire, PR1 8AF

Email: enquiries@enwl.co.uk
Web: www.enwl.co.uk

Direct line: 0843 311 3700
Email: paul.bircham@enwl.co.uk

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Dear Chris

DPCR5 Closeout Methodologies - further changes since informal consultation

I respond to Anna Rossington's open letter of 2 December concerning proposed revisions to your initial consultation approach on Network Output Measures (NOMs).

I set out below Electricity North West's view on each of your proposed changes.

Proposal to apply a financial adjustment for fault rate performance

We disagree with your proposal to apply financial adjustments for fault rate performance.

It is inappropriate to include an adjustment that has not been discussed with licensees during DPCR5. DNOs are entitled to rely on documents published at the time and discussions with Ofgem since as providing a legitimate expectation of what adjustments will be made.

We also note that, notwithstanding our principled view that no financial penalty should be applied for fault rate performance, it is impracticable to establish a clear link between fault rate performance and investment levels. We note that there was no reconciliation undertaken of planned investment to presumed fault rate outcomes as part of the DPCR5 price control process.

Ofgem acknowledged the potential difficulties associated with mechanistic adjustments in its DPCR5 decision making.

'...We do not intend at DPCR6 to mechanistically tie a revenue adjustment to output performance. Where a DNO's performance falls short (or looks like it will fall short) of that agreed at the start of DPCR5, there will be a detailed discussion with us on the level of network investment undertaken over the period...' (paragraph 17.41 of DPCR5 Initial Proposals Incentives and Obligations document)

We note that Ofgem has not yet shared its proposed methodology for monetising fault rate performance with DNOs and we have therefore not yet been able to comment on it.

Proposal to change agreed DPCR5 HI and LI outputs to account for material changes

Health Index (HI)

We agree that Ofgem should take account of material changes in its assessment of whether HI Network Output Measures have been delivered. However, any adjustment for material changes must be applied carefully and must reflect the nature of each material change.

Central to whether an adjustment should be made to reflect a material change is whether the material change affects the target delta or not ie whether the DNO could only have achieved its actual delta because of the material change.

If a DNO could have achieved its actual delta without the Material Change, then no adjustment to the target needs to be made.

We have proposed a methodology to achieve this to Ofgem.

Load Index (LI)

Your proposal to apply a 'material changes' adjustment as part of your LI NOMs methodology is inappropriate. It is not acceptable to apply an adjustment after the period has ended that has not been previously indicated. In contrast to HI NOMs, where the collection of data regarding material changes has been routinely captured throughout the DPCR5 period, no discussions were held with us during DPCR5 about the potential for this, nor was any data collected in the annual RIGs. Introducing such an approach would undermine the regulatory certainty on which our low cost of equity relies.

Our understanding of the policy is that the material changes approach was deliberately not applied to LIs because a separate uncertainty mechanism (the Load Related reopener) was put in place to address the volume uncertainty in this area. Any change of this nature would fundamentally change the required interactions between these key mechanisms and – depending on how it is implemented – could distort the efficiency incentives that were deliberately placed on DNOs in the DPCR5 Final Proposals to seek to identify efficiencies in this key area of expenditure.

Logging up for flood prevention expenditure for SSEH

On your proposal to include an additional methodology for assessing and logging up the amounts that Scottish and Southern Electricity has spent on flood prevention in its Hydro region, we agree that as a commitment was made in the DPCR5 Final Proposals to include a logging up mechanism this must be included in the closeout mechanisms. Given that the cap on the maximum amount that can be logged up is relatively small it will be important to ensure that the methodology and associated data requirements are proportionate to the amount of money involved.

If you have any questions regarding our response please do not hesitate to contact me, Jonathan Booth or Sarah Walls.

Yours sincerely

Paul Bircham
Networks Strategy and Technical Services Director

cc: Grant McEachran