Grant McEachran
RIIO Electricity Distribution
Ofgem
3rd Floor, Cornerstone
West Regent Street
Glasgow G2 2BA

Regulatory Affairs
Ground Floor, Lakeside West
30 The Causeway
Staines
Middlesex
TW18 3BY

14 August 2017.

Dear Grant,

DPCR5 Close out: Consultation on proposed adjustments

Thank you for the opportunity to respond to the above consultation. This is a non-confidential response on behalf of the Centrica Group, excluding Centrica Storage.

We welcome efforts to ensure distribution network operators (DNOs) are held to account for the package of outputs they were funded to deliver as part of the fifth electricity distribution price control (DPCR5). We believe price control frameworks should be calibrated so that rewards available for genuinely efficient delivery are always greater than those accruing from 'good luck' or over-forecasting. DNOs spent 10% less (£823m) than cost baselines[1]. Ofgem has recognised there was a "*...drop in reinforcement, demand connections and high value projects because of economic conditions...*"[2], which, in part, reduced network investment needed. The proposed adjustments, totalling £207m, are positive steps towards ensuring rewards are justified.

Ofgem considers all DNOs have delivered network outputs (NOMs) equivalent to what they committed to deliver at the start of DPCR5. Ofgem's assessment shows a large over-delivery in respect of Load Index (LI) risk reduction. It is not clear how much of this resulted from reductions in demand relative to that forecast at the start of DPCR5 and how much can be attributed to network investment funded by the DPCR5 allowances (which were based on those initial demand forecasts).

If lower than forecast levels of demand materially contributed to DNOs meeting (and exceeding) LI targets, financial benefits to the DNOs accrue from factors other than efficient delivery. Both re-opener mechanisms and the High Value Project outputs mechanisms have been able to return some of the expenditure savings to consumers resulting from lower than forecast demand. In contrast, the NOMs mechanism has not been able to do this because delivered outputs are currently not normalised for that effect. We believe that lower than forecast demand would have affected the level of investment in respect of LI deliverables, given it reduced the level of investment in respect of the HVP deliverables. Ahead of the next set of price controls, all mechanisms should be improved to ensure that the impacts of factors such as demand can be isolated and, therefore, financial benefits to the DNOs reflect only genuinely efficient delivery.

[1] Electricity Distribution Company performance 2010 to 2015, paragraph 2.18. (https://www.ofgem.gov.uk/publications-and-updates/electricity-distribution-company-performance-2010-2015).
[2] Electricity Distribution Company performance 2010 to 2015, paragraph 2.18:

We agree with the disallowance of efficiency claims arising out of what was suggested to be the implementation of innovative solutions. Solutions that were already common practice or were widespread should not be treated as innovative. We note a number of solutions treated as innovative involve DSR/third party agreements. If these agreements involve reduced network charges for those third parties relative to what they would have been without those agreements, it is then important to recognise that such reduced network charges will have to be paid for by all other customers and so this should be taken into account in estimating any cost saving.

Ofgem has acknowledged that the main area of expenditure in which the DNOs have outperformed price control assumptions is network investment. Further, Ofgem estimated an average return on equity for DPCR5 at around 12%, significantly higher than the 6.7% baseline[3]. Reduced network investment because of the economic downturn during DPCR5 has contributed to this significantly higher average return on equity. It would useful for Ofgem to provide the effect of these adjustments on the return on equity.

We hope you find these comments helpful. Please contact me if you have any questions.

Yours sincerely,

Andy Manning
Director - Network Regulation, Forecasting and Settlements

[3] Electricity Distribution Company performance 2010 to 2015, paragraph 2.36.