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RIIO-T1: Initial Proposals for SP Transmission Ltd and Scottish Hydro Electric Transmission Ltd

Consultation

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Overview:

This document sets out our Initial Proposals for the transmission price controls for SP Transmission Ltd (SPTL) and Scottish Hydro Electric Transmission Ltd (SHETL) from 1 April 2013 to 31 March 2021.

This will be the first transmission price control to reflect the new RIIO (Revenue = Incentives + Innovation + Outputs) model. Under RIIO we are adopting a very different process for setting price controls. Companies are required to develop and submit well-justified business plans, supported by the views of stakeholders, setting out what they will deliver. Companies that submit high-quality plans will be offered the option of settling price controls early – “fast-tracking”.

Following our recent assessment we consider that both SPTL and SHETL have set out well-justified business plans and therefore that those plans are suitable for fast-tracking. SPTL and SHETL’s business plans form the basis of these Initial Proposals.

We are seeking respondents’ views on the package of proposals put forward by each company.

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Associated documents

Supporting Documents

RIIO-T1: Initial Proposals for SP Transmission Ltd and Scottish Hydro Electric Transmission Ltd - Supporting Document
http://www.ofgem.gov.uk/Networks/Trans/PriceControls/RIIO-T1/ConRes/Documents1/SPT_SHETL_support_IP.pdf

Cost of debt indexation model update: RIIO-T1 and GD1
http://www.ofgem.gov.uk/Networks/Trans/PriceControls/RIIO-T1/ConRes/Documents1/Cost_of_debt_model.xlsx

Illustration of SHETL's bespoke cost of debt index
http://www.ofgem.gov.uk/Networks/Trans/PriceControls/RIIO-T1/ConRes/Documents1/Cost_of_Debt_SHETL.xlsx

RIIO-T1: Initial Proposals for SPTL and SHETL for the next transmission price control – Impact Assessment
http://www.ofgem.gov.uk/Networks/Trans/PriceControls/RIIO-T1/ConRes/Documents1/SPT_SHETL_IA.pdf

Other Relevant Documents

RIIO-T1: Decision on fast-tracking for SPTL and SHETL
http://www.ofgem.gov.uk/Networks/Trans/PriceControls/RIIO-T1/ConRes/Documents1/Further%20assessment%20of%20RIIO-T1%20business%20plans.pdf

Initial assessment of RIIO-T1 business plans and proportionate treatment
http://www.ofgem.gov.uk/Networks/Trans/PriceControls/RIIO-T1/ConRes/Documents1/busplanletter.pdf

Decision on strategy for the next transmission price control - Overview paper
http://www.ofgem.gov.uk/Networks/Trans/PriceControls/RIIO-T1/ConRes/Documents1/T1decision.pdf

Handbook for implementing the RIIO model - Ofgem, October 2010
http://www.ofgem.gov.uk/Networks/rpix20/ConsultDocs/Documents1/RIIO%20handbook.pdf

Glossary
http://www.ofgem.gov.uk/Networks/GasDistr/RIIO-GD1/ConRes/Documents1/Glossary.pdf

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Executive Summary

Britain's gas and electricity network companies face unprecedented challenges. They will need to invest over £30 billion over the next decade to develop smarter networks, to meet environmental challenges and to secure energy supplies. Against this backdrop, it is more important than ever that network companies can show consumers they are getting value for money.

This is the first price control to be conducted under our new RIIO model (Revenue = Incentives + Innovation + Outputs). Through RIIO-T1, we are setting the regulatory framework to apply to electricity and gas transmission companies from 1 April 2013 to 31 March 2021. The objective of RIIO is to encourage network companies to play a full role in the delivery of a sustainable energy sector, and to do so in a way that delivers value for money for existing and future consumers.

Proportionate treatment is a key part of the RIIO model. It provides strong financial and reputational incentives on network companies to step up to the challenge of providing well thought out and well-justified business plans. Companies that submit high quality plans will be able to agree price controls early, i.e. achieve "fast-tracking".

A RIIO business plan must achieve a high-quality to be considered suitable for fast-tracking. As RIIO-T1 marks the first implementation of RIIO, we have provided for greater iteration between the first business plan submission and our fast-track decision than we intend in the future. Importantly, this does not mean that we have lowered the bar for a company to be fast-tracked in RIIO-T1.

In October we took the decision to retain SP Transmission Ltd (SPTL) and Scottish Hydro Electric Transmission Ltd (SHETL) in the RIIO-T1 fast-track process. Both companies have since engaged constructively in the process to revise their plans to address outstanding issues. As a result, both companies have made significant changes to their plans.

We consider that the revised price control packages put forward by SPTL and SHETL constitute well-justified business plans which demonstrate a clear consideration of the views of their stakeholders and provide good value for money to both existing and future consumers. Consequently we are putting forward for consultation Initial Proposals for fast-tracking those plans.

The companies have put forward a comprehensive package of outputs which reflect the interest of their stakeholders. They have strong incentives to deliver those outputs and face penalties for failure to deliver.

The companies have also put forward proposals to address the areas of risk and uncertainty which they see over the RIIO-T1 period and identified the role of innovation in delivering their plan.

Under these Initial Proposals we would allow upfront funding for around £2.3bn of investment in the Scottish transmission network with scope for an additional £3.7bn to be brought forward for assessment during the RIIO-T1 period. This gives total investment of around £6bn in 2009/10 prices (or £7.6bn after inflation).

The two transmission companies have estimated the impact of their price control proposals on consumers' bills. SHETL have estimated that their charge to the average domestic customer will increase from around 38p in 2011/12 to £2.45 in 2020/21. SPTL have estimated an increase in charge of around 10p per annum in the annual charge for the average domestic customer. In total this implies an increase of around 35p per year for the average domestic consumer over RIIO-T1. The actual impact will depend on a number of factors.

While we consider both SPTL and SHETL's plans are of sufficient quality to be consulted on through fast-tracking Initial Proposals we recognise there are areas for further work in both plans. We are therefore identifying areas where we expect the companies to undertake further work. These are broadly the same for both companies and include:

- Robust Environmental Management – demonstrating a sustainable approach to identify and deliver improved environmental performance at good value to consumers over RIIO-T1 and in the long term.

- Network Availability and Customer Satisfaction outputs – there are ongoing workstreams in these areas and we expect SPTL and SHETL to continue to work with National Grid Electricity Transmission plc (NGET) to come forward with proposals.

In addition, we expect the companies to continue to actively work to improve their processes for stakeholder engagement.

We are putting forward these Initial Proposals for consultation. We welcome respondents' views on these proposals. We will consider respondents' views and, if appropriate, put forward Final Proposals in April 2012.

1. Introduction

Chapter Summary

This chapter explains the structure and purpose of this document and sets out the context of the Initial Proposals.

Purpose of this document

1.1. This document sets out, for consultation, our “fast-track” Initial Proposals for SP Transmission Ltd (SPTL) and Scottish Hydro Electric Transmission Ltd (SHETL) for the next transmission price control, RIIO-T1. SPTL and SHETL own and maintain the transmission network assets in Scotland. This price control will cover the eight-year period from 1 April 2013 to 31 March 2021.

1.2. This document aims to provide an accessible overview of the Initial Proposals for SPTL and SHETL. Alongside this document we have published a Supporting Document.[1] The Supporting Document is aimed primarily at network companies, investors and those who require a more in-depth understanding of the proposals. The Supporting Document is divided into the key areas of the price control packages to allow the reader to dip into the parts of most interest to them.

1.3. These Initial Proposals are different from those we have set out in previous price control processes. This is for two reasons.

(1) At an early stage in the RIIO process we consulted, and then published decisions, on the regulatory framework for RIIO-T1 – our Strategy Decision document[2] (“Strategy Decision document”). That document set out the regulatory framework for the RIIO-T1 price control.

(2) We are putting forward the business plans of SPTL and SHETL for “fast-tracking”. Fast-tracking means finalising the price controls of a company at an early stage in the process on the basis that we consider its proposals are well justified and in the interests of consumers. These proposals are therefore based directly on the revised RIIO-T1 business plans developed by SPTL and SHETL. These plans are available at the following links:

- SPTL: http://www.spenergynetworks.co.uk/publicinformation/stakeholder_riio.asp
- SHETL: http://www.ssepd.co.uk/Projects/TransmissionPriceControlReview/

1.4. In a number of areas of this document we reference both our Strategy Decision document and the companies’ plans where further detail is set out to support these Initial Proposals.

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[1] RIIO-T1: Initial Proposals for SPTL and SHETL - Supporting Document http://www.ofgem.gov.uk/Networks/Trans/PriceControls/RIIO-T1/ConRes/Documents1/SPT_SHETL_support_IP.pdf

[2] Decision on strategy for the next transmission price control - RIIO-T1 http://www.ofgem.gov.uk/Networks/Trans/PriceControls/RIIO-T1/ConRes/Documents1/T1decision.pdf

1.5. We note that there are differences in detail between the packages put forward by SPTL and SHETL. This is to be expected as the RIIO framework puts the onus on individual companies to develop plans which reflect the challenges of their own businesses and which deliver in the interests of their own stakeholders. In setting out Initial Proposals we are considering whether each package as a whole delivers value for money to the consumer. We are therefore seeking views on the appropriateness of the packages as a whole.

1.6. This document does not set out Initial Proposals for National Grid Electricity Transmission plc (NGET) or National Grid Gas plc (NGG). We are taking forward the controls for NGET and NGG under the non-fast-tracking process. Both will submit revised business plans (for both the TO and system operator elements) in March 2012 and we intend to publish, for consultation, our Initial Proposals for NGET and NGG in July 2012.

RIIO

1.7. In October 2010[3], we announced a change in the way we will regulate the GB onshore network companies. We introduced the RIIO (Revenue = Incentives + Innovation + Outputs) model. The overriding objective of the RIIO model is to drive real benefits for consumers by providing energy network companies with strong incentives to meet the challenges of delivering a low carbon economy and a sustainable energy sector at a lower cost than would have been the case under the previous approach.

1.8. The price control process under RIIO is different to previous controls. In particular, under RIIO the onus is on network companies to develop well-justified business plans. Each network company is required to develop detailed plans which demonstrate how they will deliver in the interests of both existing and future consumers and how they will meet the challenges associated with facilitating the move to a low carbon economy. Companies which rise to this challenge may benefit from proportionate treatment and potentially “fast-tracking”. Proportionate treatment provides benefits in terms of enabling Ofgem to focus our resources where they can deliver most value for consumers.

1.9. Fast-tracking provides strong incentives for the companies. Fast-tracking means that a company, by receiving its Final Proposals approximately a year ahead of the implementation of its control, will be able to get on with business as usual without focusing as much resource on the price control process. It also means a company will be a significant driver of its own review outcome. We will aim to ensure that a company who is fast-tracked does not secure a settlement that means it is worse off than had it remained in the price control process.

1.10. We published a timetable for RIIO-T1 in our Strategy Decision document. An updated timetable for the review is set out in Appendix 2.

[3] See footnote 2

Role of this document in the RIIO-T1 process

1.11. Our Strategy Decision document set out the key elements of the regulatory framework that the transmission owners (TOs) would need to understand in order to develop their business plans. We received the TOs' RIIO-T1 business plans at the end of July 2011. We assessed those plans against the criteria that we had set out in our Strategy Decision document.

1.12. In October we published our initial assessment of the RIIO-T1 business plans.[4] This set out our assessment of the quality of the plans and indicated those areas that may be suitable for proportionate treatment. Our initial assessment concluded that none of the plans was suitable for fast-tracking in its existing format but that the scale of the outstanding issues for SPTL and SHETL may allow them to resolve these in a timeframe consistent with fast-tracking. On this basis we retained SPTL and SHETL in the fast-tracking process. Our assessment outlined the issues SPTL and SHETL would need to address in order for us to develop Initial Proposals in early 2012.

1.13. In late December both companies submitted revised plans in which they sought to address outstanding issues. We assessed these plans using the same criteria we used to assess the original plans. On 23 January we published our decision[5] that the business plans of SPTL and SHETL were of sufficient quality to be consulted upon through fast-tracking Initial Proposals with a view to reaching early settlement of their price controls, i.e. that their business plans are suitable for fast-tracking.

1.14. The purpose of this document is to set out the basis of the Initial Proposals for SPTL and SHETL and to seek respondents' views on the suitability of that package of proposals for fast-tracking. The document sets out: what network companies propose to deliver during the next price control period; the incentives that would be placed around that delivery; the costs the companies would be able to recover and the arrangements for addressing risk and uncertainty around those costs; and the basis of the financial package for determining the companies' allowed revenues.

Stakeholder engagement

1.15. The RIIO framework places considerable emphasis on stakeholder engagement, both by the network companies and by Ofgem. The requirement on TOs to undertake detailed stakeholder engagement and to demonstrate how this has been reflected in their plans is a key component of the RIIO process. In our assessment of the July business plans we noted that both SPTL and SHETL had undertaken significantly more stakeholder engagement than during any previous price control process. However, we noted that there was scope for improvement in both plans.

1.16. Both SPTL and SHETL have made progress in this area. They have addressed a number of our concerns on stakeholder engagement including increasing their

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[4] Initial assessment of RIIO-T1 business plans and proportionate treatment – October 2011 http://www.ofgem.gov.uk/Networks/Trans/PriceControls/RIIO-T1/ConRes/Documents1/busplanletter.pdf

[5] RIIO-T1: Decision on fast-tracking for SP Transmission Ltd and Scottish Hydro Electric Transmission Ltd http://www.ofgem.gov.uk/Networks/Trans/PriceControls/RIIO-T1/ConRes/Documents1/Further%20assessment%20of%20RIIO-T1%20business%20plans.pdf

stakeholder base and developing a refined strategy for stakeholders who have identified difficulties in engaging. We still consider both companies could do more but that they are progressing in the right direction. We expect the companies to keep developing their approaches and to seek continually to improve throughout RIIO-T1. We will continue to monitor the companies' progress in this area.

Our engagement

1.17. Since the start of RIIO-T1, we have adopted a multi-layered process to ensure that all affected parties have effective opportunities to engage in the review. When we have engaged with stakeholders, we have sought to adhere to our principles for effective enhanced engagement set out in the RIIO handbook.[3]

1.18. The key elements of our recent process have been:

- Consultation on our assessment of the July business plans to which we received eleven responses. These are summarised in Appendix 3. We took these views into consideration in reaching our decision to consult on Initial Proposals for fast-tracking SPTL and SHETL. Where views expressed relate to the assessment of the controls for NGET and NGG, we will take these into consideration in our future assessment of their revised plans.
- A further meeting of the Price Control Review Forum (PCRF)[6] to discuss our assessment of the plans.
- A range of bilateral meetings with both the transmission companies and other interested stakeholders.

1.19. We are publishing these Initial Proposals for consultation and will continue to engage with all interested parties throughout the RIIO-T1 process.

Consumer Challenge Group (CCG)

1.20. Separate from our stakeholder engagement processes, we have benefited from feedback from the CCG, which comprises consumer and environmental experts acting as a critical friend to Ofgem.

1.21. The CCG has a critical role in ensuring that consumers' views are fully considered as part of the price control process. We have formed a single CCG for RIIO-T1 and the concurrent gas distribution price control review (RIIO-GD1). The group comprises eight members appointed by us on the basis of their expertise in the interests of existing and future consumers and energy sector knowledge.

1.22. Separate from our stakeholder engagement processes, we have benefited from feedback from the CCG, which comprises consumer and environmental experts acting as a critical friend to Ofgem.

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[6] Further information on the PCRF is set out on our website at:
http://www.ofgem.gov.uk/Networks/PriceControls/PCRF/Pages/PCRF.aspx

1.23. Among the key points raised by the CCG at this stage are as follows:

- In relation to changes made to SPTL and SHETL's plans the CCG made the general point that any changes should be justified through a thorough consideration of options in conjunction with stakeholders. This includes areas where changes have been made for consistency with the Strategy Decision document.
- In relation to areas for improvement the CCG noted that it was important that the companies recognised the areas that required further development and committed to strengthening their approaches in these areas going forward.
- The CCG noted that it was important that the companies' updated plans are clear and highlight areas of change backed by justification along with areas of weakness and strategies for continued improvement.

1.24. The CCG made a made of other specific points on individual policy areas these are discussed in the relevant sections of this document.

Quality of the revised plans and process of revision

1.25. Under RIIO, network companies are incentivised to submit to us well-justified business plans. A well-justified business plan should cover the required content, follow a clear and logical structure with an appropriate level of focus given to each area and be supported by effective stakeholder engagement.

1.26. Throughout the development of RIIO-T1 we have provided guidance on what a well-justified business plan should look like. We included an annex on this issue in our initial open letter consultation in July 2010 and further detail in our December 2010 and March 2011 Strategy Documents. We also provided data templates for supporting data and a financial model for network companies to complete.

1.27. SPTL and SHETL have made significant changes to their plans since July. As a result of work undertaken by both companies we note the following outcomes:

- the companies have updated their business plans by improving the quality of some sections and providing additional context and clarity in others
- the companies have provided information in relation to all of the areas of their plans where we indicated there had previously been omissions, e.g. efficiency and market testing
- the companies have revised a number of their proposals either to align them with our Strategy Decision document or to seek to enhance those proposals
- the companies have addressed a number of our concerns on stakeholder engagement, including increasing their stakeholder base and developing a refined strategy for stakeholders who have identified difficulties in engaging.

1.28. The impact of these changes is that both companies have now put forward, what we consider to be, well-justified business plans which are justified by stakeholder engagement and which provide a package that brings significant benefits to consumers.

1.29. As set out in our October letter, as RIIO-T1 is the first implementation of the RIIO framework, we have provided for iteration between the first business plan submission and our fast-tracking decision. We do not intend to include this extra stage in the future. This includes in the gas distribution price control (RIIO-GD1) and the next electricity distribution price control (RIIO-ED1) processes. As network companies learn what is expected from them under RIIO, for example in terms of a more joined up assessment, testing different options and employing long-term thinking across the whole plan, we do not consider there will be a requirement for significant iteration.

Impact assessment

1.30. Alongside this document, we are also publishing an impact assessment (IA).[7] This is based on the IA we published for RIIO-T1 in December 2010[8]. We consider that the benefits and impacts outlined in the December IA remain applicable in most part to the updated proposals outlined in this document but we have updated this document where necessary.

1.31. We also intend to publish an IA with the Initial Proposals for NGET and NGG

Interaction with other policy areas

SO incentives

1.32. In parallel with our work on RIIO-T1, we are working to set system operator[9] (SO) incentives for the period from 1 April 2013. We note that we will work with the SOs to finalise, for each output and cost incentive scheme, the appropriate scheme length. On 31 January we published our principles and policy document[10]. One of our objectives across the two workstreams is to align the incentives facing SO and TOs to encourage effective joint working. One of the areas where this will bring benefits is in relation to network availability, which is relevant to the RIIO-T1 outputs. The interaction between the outputs here and this work more widely is considered in more detail in Chapter 2 of the Supporting Document.

Broad environmental incentive

1.33. In our Strategy Decision document we noted our intention to include a reputational incentive on promoting low carbon energy flows. We further noted that, subject to consultation, we may introduce an incentivised financial reward which would future proof the output framework for new opportunities arising over RIIO-T1.

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[7] RIIO-T1: Initial proposals for SPTL and SHETL for RIIO-T1 – Impact Assessment http://www.ofgem.gov.uk/Networks/Trans/PriceControls/RIIO-T1/ConRes/Documents1/SPT_SHETL_IA.pdf

[8] Consultation on strategy - RIIO-T1 and GD1 Impact assessment – December 2010 http://www.ofgem.gov.uk/Networks/Trans/PriceControls/RIIOT1/ConRes/Documents1/T1%20and%20GD1%20IA.pdf

[9] The SO has responsibility for day-to-day system operation, including balancing of the system and constraint management, of the electricity transmission network. National Grid Electricity Transmission plc (NGET) is the electricity SO.

[10] Ofgem: SO incentive schemes, principles and policy, 31 January 2012: http://www.ofgem.gov.uk/MARKETS/WHLMKTS/EFFSYSTEMOPS/SYSTOPINCENT/Documents1/SO%202013%20Principles.pdf

1.34. We intend to publish a consultation on this area shortly. This consultation will consider additional financial incentives to sharpen the environmental considerations demonstrated by the transmission companies throughout the RIIO-T1 period.

Transmission Investment Incentives

1.35. We introduced Transmission Investment Incentives (TII) in 2009 to supplement capital allowances and deep revenue drivers set within TPCR4 to facilitate the timely delivery of critical electricity transmission infrastructure projects. These arrangements will continue for the rollover year 2012/13.

1.36. For RIIO-T1 we are introducing arrangements to enable TOs to request Ofgem to determine the efficient forecast costs of delivering wider works outputs and to adjust the TOs' wider works outputs and associated revenues during the price control period (i.e. within period determination). These arrangements will replace the TII arrangements introduced during TPCR4.

Innovation

1.37. A core part of the RIIO framework is introducing an innovation stimulus. The innovation stimulus will comprise:

- **Network Innovation Allowance (NIA)** - The NIA is a set allowance that each of the RIIO network licensees will receive to fund small-scale innovative projects as part of their price control settlement.

- **Network Innovation Competition (NIC)** - The NIC is an annual competition for funding larger more complex projects. The NIC will comprise of two competitions - one for gas and one for electricity.

- **Innovation Roll-out Mechanism (IRM)** - A Revenue Adjustment Mechanism that enables companies to apply for additional funding within the price control period for the rollout of initiatives with demonstrable and cost effective low-carbon or environmental benefits.

1.38. The innovation stimulus will be introduced as part of the RIIO-T1 and RIIO-GD1 price controls on 1 April 2013. In order to implement the innovation stimulus we will develop licence conditions which will allow companies to raise the funding and set the legal framework for the governance arrangements. The governance arrangements will provide detailed assessment criteria, guidance on obligations and requirements for the network innovation competition, as well as criteria and obligations attached to the utilisation of the NIA.

1.39. We are developing the governance arrangement through the course of 2012. An innovation working group (IWG) has been established to support this process. We intend to hold the first NIC in 2013, with the winning projects receiving funding from 1 April 2014. Innovation is discussed further in Chapter 3 of the Supporting Document.

Implementing competition in onshore electricity transmission

1.40. In March 2011, we set out our initial thoughts on the legislative and regulatory framework together with the process for enabling competition in new onshore infrastructure development. Our aim is that the regime will be in place by April 2013, the start of the RIIO price control period. This means that, if the circumstances are appropriate, we will be able to instigate a selection process for a project, or specific works on a given project where that project comprises multiple elements, where we had concerns that the plans submitted by the company do not represent good value for consumers.

1.41. A consultation[11] is currently underway which seeks views on the code and licence modifications that would be necessary to recognise new third party TOs and certain issues relating to the proposed selection process. Our next steps will be to initiate the code and licence modifications in our next consultation in Spring 2012, which at the same time will present our further thinking on the design of the selection process and the roles and responsibilities of third party TOs. We plan to publish our final decisions on these questions in summer 2012 alongside the Initial Proposals for our new regulatory framework for electricity and gas, RIIO-T1 and RIIO-GD1.

Charging volatility

1.42. In our Strategy Decision document we noted concerns raised by stakeholders that volatility in the price control settlement has an adverse impact on consumers. This issue cuts across all the network companies. We intend to consult on this issue in due course. Our consultation will identify the elements of the price control that create volatility and propose potential solutions to address this volatility. This should not change the package that is being consulted on in these Initial Proposals.

Structure of this document

1.43. The remainder of this document provides an overall summary of the Initial Proposals for SPTL and SHETL. It is structured as follows:

- Chapter 2 sets out a summary of the package of Initial Proposals for SPTL.
- Chapter 3 sets out a summary of the package of Initial Proposals for SHETL.
- Chapter 4 sets our next steps for RIIO-T1.

1.44. Alongside this document we have published a Supporting Document. This provides further information on each of the individual areas of the price control packages for SPTL and SHETL.

[11] RIIO-T1 Implementing competition in onshore electricity transmission http://www.ofgem.gov.uk/Networks/Trans/PriceControls/RIIO-T1/ConRes/Documents1/111216_Consultation_Competition.pdf

2. Summary of Initial Proposals for SPTL

Chapter Summary: This chapter summarises the Initial Proposals for SPTL.

Question1: Do you consider that SPTL has put forward a business plan that is suitable for forming the basis of its price control settlement?

Introduction

2.1. This chapter summarises the key components of SPTL's Initial Proposals. These proposals are based on the information set out in SPTL's updated RIIO-T1 business plan. Further detail on each of the areas set out below is provided in our Supporting Document which we have published alongside this document.[12]

Outputs and incentives

2.2. RIIO is an outputs-led framework. It is important that throughout the RIIO-T1 period, the TOs understand what they are expected to deliver and are held to account for delivery.

2.3. Table 1 summarises the outputs that SPTL has stated that it will deliver, and will be required to deliver, during RIIO-T1. It also outlines the associated incentives. These closely reflect the overall package of outputs that, following consultation, we set out in our Strategy Decision document.

2.4. We note that a number of the incentives are linked to the % of allowed revenue. To maintain strong output incentives and appropriate revenue allowances for specific activities it is important that the caps and collars on these do not just reflect the opening base revenue allowance. They should also adjust in response to ongoing, but uncertain, changes in revenue in order to better reflect the true change in network totex and other in-period adjustments over the price control period. References to '% of allowed revenue' therefore reflect a combination of the opening base revenue allowance plus within period adjustments captured through annual iteration of the financial model. This is discussed in further detail in Chapter 2 of the Supporting Document.

Table 1 - Outputs and incentive parameters proposed by SPTL

Category	Output	Incentive
Safety	Compliance with safety obligations set by Health and Safety Executive (HSE)	Statutory requirements. No financial incentive.

[12] RIIO-T1: Initial Proposals for SP Transmission Ltd and Scottish Hydro Electric Transmission Ltd - Supporting Document
https://www.ofgem.gov.uk/Networks/Trans/PriceControls/RIIO-T1/ConRes/Documents1/SPT_SHETL_support_IP.pdf

Category	Output	Incentive
Reliability	Primary output based on maintaining a low level of Energy Not Supplied (ENS). SPTL propose a baseline performance of ENS of 225MWh per annum.	An incentive rate of £16,000/MWh[13] which is closely aligned with the value of lost load (VoLL). A collar on financial penalties which limits the maximum penalty to 3% of allowed revenues. A licence condition on minimum performance standard.
Availability	Plan for finalising a network availability policy detailing what they will be held accountable for in conjunction with the SO, including managing constraints.	Reputational incentive
Customer Satisfaction	Plan for working with the TOs to develop a stakeholder survey on their performance in relation to the activities that SPTL carries out as TO.	Up to +/-1% of allowed revenue
Connections	Requirement to meet existing licence requirements in relation to connections	Downside only penalty of up to 0.5% of allowed revenue.
Environmental	SF_6 – a baseline built from best practice leakage ratings.	Differences to baseline subject to reward or penalty based on the non-traded carbon price for carbon equivalent emissions
	Electricity losses – baseline to be finalised ahead of 2013 for the expected impact of its proposed investment on modelled losses.	Reputational incentive
	Business Carbon Footprint (BCF) - a baseline for RIIO-T1 to be further refined.	Reputational incentive
	Visual amenity – commitment to a range of mitigation measures.	No requirement for allowance to reduce the impact of existing infrastructure given lack of applicability in its area.
Wider works (new investment)	SPTL will provide 3,300MW of additional network transfer under its proposed baseline package.	Penalties for late / non delivery capped at 10% of allowed revenue.

2.5. As this is the first implementation of the RIIO framework, we anticipated that there may be areas where further work would be needed before the outputs could be finalised. The areas where SPTL will be required to undertake additional work are:

- Availability – Each of the transmission companies is required to develop a network availability policy clarifying what the SO, and other stakeholders, can

[13] The actual incentive rate is effectively halved consistent with the application of the 50% sharing factor, and will be further adjusted for inflation.

expect from the three TOs insofar as its actions affect the availability of the transmission network. SPTL is involved in an ongoing work stream with SHETL and NGET with the purpose of coordinating the companies' network availability policies.

- Customer satisfaction – Each of the TOs is required to develop a customer satisfaction survey. To ensure their approaches are broadly consistent the three TOs are working together to develop these.
- Environmental outputs – SPTL set out baselines for some of the environmental outputs required in RIIO-T1. However, it has further work to do to firm up the performance levels they will deliver in relation to losses and its BCF. It also needs to demonstrate an enduring strategy overall to identify and deliver improved environmental performance at good value to consumers over RIIO-T1 and in the long term across all of the environmental outputs.

2.6. We expect SPTL to provide more detail on their processes to finalise these outstanding areas. This will need to be taken forward between now and end-March 2012 to inform our decisions on Final Proposals. We recognise that in some areas that work will continue throughout 2012 to ensure the new arrangements are in place for the start of RIIO-T1.

Innovation

2.7. There are a number of components of the innovation stimulus package. These were summarised in Chapter 1. In their business plan SPTL set out a consideration of innovation through its plan as well as providing a specific innovation strategy.

2.8. SPTL highlights a consideration of innovation in its business plan. SPTL noted the importance of innovation to delivering its plan and, in particular, to enable it to provide economic new windfarm connections and enhance its infrastructure. It also demonstrates the variety of innovations that are being delivered through its key projects.

2.9. SPTL has published an updated innovation strategy setting out how it intends to innovate in RIIO-T1. SPTL has requested an annual innovation allowance of 0.75% of allowed revenue. We do not consider justification has been provided for an allowance greater than 0.5%. 0.5% of allowed revenue is the default position in our Strategy Decision document and we are using this for SPTL's Initial Proposals.

2.10. If SPTL considers that they can justify a higher level of allowance then they may put forward further evidence by 5 March 2012. We will consider that evidence, alongside any consultation feedback, in setting the Final Proposals.

Cost efficiency

2.11. There are various costs that SPTL incurs as a TO and for which it seeks to recover revenue in its price control. The main costs areas are:

- Load-related capex - the investment required to connect new generators and customers to the transmission network, to upgrade the existing network including boundaries between TOs and to cater for growth in demand.

- Non-load related capex - the expenditure required to replace existing assets on the TO network, but also includes expenditure relating to network resilience, flooding, physical security and a telecoms network upgrade.
- Operating costs (Opex) – the ongoing costs of running the TOs' business, including asset maintenance and support services.

2.12. Table 2 sets out the costs we propose to provide through Initial Proposal to deliver SPTL's business plan.

Table 2 – Key cost parameters proposed by SPTL

Parameter	**RIIO-T1 Total**
	SPTL's Best view[14] (2009/10 prices)
Load-related capex (baseline)	£0.8bn
Load-related capex (subject to uncertainty mechanisms)	£0.5bn
Non-load related capex	£0.7bn
Total capex	**£2.0bn**
Total controllable opex	**£0.2bn**

Financial proposals

2.13. The financial package comprises a number of elements. These elements combine to determine the total allowed revenue that SPTL will be able to recover over RIIO-T1. Table 3 sets out the key financial parameters in the Initial Proposals.

Table 3 – Key financial parameters put forward by SPTL

Parameter	**Value**
Cost of equity (post-tax real)	7%
Cost of debt (pre-tax real)	Indexed using 10 -year simple trailing average
Notional gearing	55%
Depreciation profile	Straight line: 20 years on existing assets, 45 years on new assets
Asset lives transition	one price control period
Totex capitalisation rate	90%
Total allowed revenue (best view) for RIIO-T1	**£2145m**

Uncertainty mechanisms

2.14. SPTL set out in their business plan a range of mechanisms in the RIIO-T1 control to help it manage the potential uncertainty it has identified during the eight-year price control period.

2.15. One key uncertainty mechanism is the efficiency incentive rate which determines the percentage of underspend/overspend against expenditure allowed at the price control review that is kept by the company responsible. The remaining savings/losses are passed through to consumers. SPTL proposes an efficiency incentive rate of 50%.

[14] This reflects the companies' view of the most likely outcome. It is based on the Gone Green 2020 scenario.

2.16. Table 4 sets out an overview of the other uncertainty mechanisms.

Table 4 - Uncertainty mechanisms proposed by SPTL

Uncertainty	Proposed mechanism
Inflation	Adjust revenues for changes in the Retail Price Index
Volume of new generation connections	Volume driver for generation connections to flex revenues as the cumulative generation capacity deviates from 4,393MW, including an opex adjustment of 1% of new connections works above the capacity output.
Wider reinforcement works	Within period revenue adjustment for projects that currently fall under TII and Transmission Investment in Renewable Generation (TIRG), including an opex adjustment of 1% of new Strategic Wider Works.
Non load related replacement/renewal	Within period revenue adjustment for up to five specified large projects.
Financial distress	Disapplication of the price control where outside the company's control.
Licence fees and network rates	Continued pass through.
Enhancement of physical security	Subject to an income adjusting event if greater than 1% of revenue. Below this level will be subject to an allowance set at the next price control.
Work force renewal	No RIIO-T2 manpower funding in base plan. Funding through a reopener at the mid period review.

3. Summary of Initial Proposals for SHETL

Chapter Summary: This chapter summarises the Initial Proposals for SHETL.

Question2: Do you consider that SHETL has put forward a business plan that is suitable for forming the basis of its price control settlement?

Introduction

3.1. This chapter outlines the key components of SHETL's Initial Proposals. These are based on the information set out in SHETL's updated RIIO-T1 business plan. Further detail on each of the areas set out below is provided in our Supporting Document.

Outputs and incentives

3.2. RIIO is an outputs-led framework. It is important that throughout the RIIO-T1 period, the TOs understand what they are expected to deliver and are held to account for delivery.

3.3. Table 5 summarises the outputs that SHETL has stated that it will deliver, and will therefore be required to deliver, during RIIO-T1. It also outlines the associated incentives. These reflect the overall package of outputs that, following consultation, we set out in our Strategy Decision document.

3.4. SHETL has proposed and justified variations to the positions set out in our Strategy Decision document in relation to its reliability and connections outputs.

Table 5 - Outputs and incentive parameters proposed by SHETL

Category	Output	Incentive
Safety	Compliance with safety obligations set out by HSE.	Statutory requirements. No financial incentive.
Reliability	Propose a hybrid approach combining: • maintaining a low level of ENS with a baseline performance of 120MWh per annum • making compensation payments to customers.	An incentive rate of £16,000/MWh[15] which is closely aligned with the value of lost load (VoLL). A collar on financial penalties which limits the maximum penalty to 3% of allowed revenues. A licence condition on minimum performance standard.
Availability	Plan for finalising its network availability policy.	No financial incentive

[15] The actual incentive rate is effectively halved consistent with the application of the 50% sharing factor, and will be further adjusted for inflation

Category	Output	Incentive
Customer Satisfaction	Plan for working with the TOs to develop a stakeholder survey on their performance in relation to the activities that SHETL carries out as TO.	Up to +/-1% of allowed revenue. Additionally, propose using a 'Standards Metric' in the make-up of the incentive.
Connections	Requirement to meet existing legal requirements. In addition, propose additional service standards.	Downside penalty of up to 0.5% of allowed revenue for failure to meet these requirements.
Environmental	SF_6 – baseline built from manufacturers' leakage ratings. To be finalised ahead of 2013.	Differences in carbon equivalent emissions relative to baseline subject to reward or penalty based on the non-traded carbon price.
	Electricity losses – baseline for the expected impact of its proposed investment on modelled losses.	Reputational incentive
	BCF – baseline to be finalised ahead of 2013.	Reputational incentive
	Visual amenity – set out a commitment to a range of mitigation measures.	No requirement for allowance to reduce the impact of existing infrastructure.
Wider works (new investment)	SHETL will provide 300MW of additional network transfer under baseline package.	Penalties for late / non delivery capped at 10% of revenue.

3.5. As this is the first implementation of the RIIO framework, we anticipated that there may be areas where further work would be needed before the outputs could be finalised. The areas where SHETL will be required to undertake additional work are:

- Availability – Each of the TOs is required to develop a network availability policy clarifying what the SO, and other stakeholders, can expect from the three TOs insofar as its actions affect the availability of the transmission network. SHETL is involved in an ongoing work stream with SPTL and NGET with the purpose of coordinating the companies' network availability policies.
- Customer satisfaction – Each of the TOs is required to develop a customer satisfaction survey. To ensure their approaches are broadly consistent the three TOs are working together to develop these.
- Environmental outputs – SHETL set out baselines for some of the environmental outputs required in RIIO-T1. However, it has more to do to firm up the performance levels they will deliver in relation to SF_6 and its BCF. We also expect SHETL to undertake more work in relation to visual amenity.

3.6. We expect SHETL to provide more detail on their processes to finalise these outstanding areas. This will need to be taken forward between now and end-March 2012 to inform our decisions on Final Proposals. We recognise that in some areas that work will continue throughout 2012 to ensure the new arrangements are in place for the start of RIIO-T1.

Innovation

3.7. There are a number of components of the innovation stimulus package. These were summarised in Chapter 1. In their business plan SHETL set out a consideration of innovation through its plan as well as providing a specific innovation strategy.

3.8. SHETL highlights a consideration of innovation in its business plan. It largely sets out its consideration of innovation in relation to efficient costs and its environmental outputs. SHETL also sets out that innovation is central to its culture and demonstrates a number of areas where they have been able to deliver innovative solutions in a business as usual manner.

3.9. SHETL published an updated innovation strategy setting out how it intended to innovate in RIIO-T1. SHETL requested an innovation allowance of 1% of allowed revenue and a different profiling of the allowance that would allow them to recover more in the early years of the control. We do not consider justification has been provided for an allowance greater than 0.5% but recognising that SHETL's allowances will increase significantly during RIIO-T1 we will allow it to recover 0.5% on average across the period of the control.

3.10. If SHETL considers that they can justify a higher level of allowance then they may put forward further evidence by 5 March 2012. We will consider that evidence, alongside any consultation feedback, in setting the Final Proposals.

Cost efficiency

3.11. There are various costs that SHETL incurs as a TO and for which it seeks to recover revenue in its price control. The main costs areas are load-related capex, non-load related capex and opex. These categories of cost are explained in Chapter 2.

3.12. Table 6 sets out the costs we propose to provide through Initial Proposal to deliver SHETL's business plan.

Table 6 – Key cost parameters proposed by SHETL

Parameter	**RIIO-T1 Total**
	SHETL's Best view (2009/10 prices)
Load-related capex (baseline)	£0.6bn
Load-related capex (subject to uncertainty mechanisms)	£3.2bn
Non-load related capex	£0.2bn
Total Capex	**£4.0bn**
Total Controllable Opex	**£0.2bn**

Financial proposals

3.13. The financial package comprises a number of elements. These elements combine to determine the total allowed revenue that SHETL will be able to recover over RIIO-T1. Table 7 sets out the key financial parameters in the Initial Proposals.

Table 7 – Key financial parameters put forward by SHETL

Parameter	SHETL proposal
Cost of equity (post-tax real)	7.0%
Cost of debt (pre-tax real)	Indexed with bespoke weightings tracking investment profile
Notional gearing	55%
Depreciation profile	Straight line: 20 years on existing assets, 45 years on new assets
Asset lives transition	two price control periods
Totex capitalisation	90%
Total allowed revenue (best view) for RIIO-T1	**£2362m**

Uncertainty mechanisms

3.14. SHETL set out in their business plan a range of mechanisms to help it manage the potential uncertainty it has identified during the eight-year price control period. One key uncertainty mechanism is the efficiency incentive rate. SHETL propose an efficiency incentive rate of 50%.

3.15. Table 8 sets out an overview of these mechanisms.

Table 8 - Uncertainty mechanisms proposed by SHETL

Uncertainty	Proposed mechanism
Inflation	Adjust revenue for changes in the Retail Price Index.
Volume of new generation connections	Volume drivers for sole-use and shared-use connections infrastructure over the respective output capacities of 1,168MW and 1,006MVA. Including an opex adjustment of 1% of new connections works above the capacity output.
Wider reinforcement works	Within period revenue adjustment for projects that currently fall under TII/TIRG, including an opex adjustment of 1% of new Strategic Wider Works.
BT 21st Century Networks	Use materiality threshold of 1% of revenue with cost incurred below the threshold logged up. SHETL could apply for a reopener for costs that exceed 1% to enable recovery within period.
Income adjusting events	Require two new categories: (1) potential for sub-sea cable faults; and (2) significant legislative or legislative driven changes.
Financial distress	Disapplication of the price control where outside the company's control.
Licence fees/network rates	Continued pass through.
Enhancement of physical security	Subject to an income adjusting event if greater than 1% of revenue. Below this level will be subject to an allowance set at the next price control.
Compensating landowners under wayleave	Subject to an income adjusting event if greater than 1% of revenue. Below this level will be subject to an allowance set at the next price control.
Mitigation of impacts on visual amenity	Requirements to be included in funding request submitted for consideration under Strategic Wider Works arrangements.

4. Next steps

Chapter Summary

The purpose of this chapter is to set out the next steps in setting the RIIO-T1 price control for SPTL and SHETL.

4.1. We welcome the views of interested parties in relation to any of the issues set out in this document and the Supporting Document. In particular, we are seeking views from respondents on the package as a whole for both SPTL and SHETL and whether they deliver in relation to meeting the high-level RIIO objectives. Responses should be provided to RIIO.T1@ofgem.gov.uk no later than **20 March 2012**. Unless clearly marked as confidential, responses will be published on our web forum.

4.2. In light of respondents' views, we will publish our final decision on fast-tracking and, if appropriate, we will also publish Final Proposals for SPTL and SHETL in April 2012. If, in light of feedback to our Initial Proposals, we decide not to fast-track SPTL and/or SHETL then they will revert to the non fast-track process.

4.3. The Final Proposals will come into effect through changes to the transmission licences on 1 April 2013. The licence obligations will also be set out in a series of supporting methodologies. In addition we will be developing a set of Regulatory Instructions and Guidance (RIGs) for RIIO-T1. The RIGs will provide the framework under which we will monitor the performance of the TOs against their price control obligations. The licence drafting process is underway. As an important part of this process we have formed a legal drafting working group covering both RIIO-T1 and RIIO-GD1. The group is chaired by Ofgem and comprises representatives from Ofgem, the TOs and the gas distribution companies (GDNs). We will begin the drafting of the supporting methodologies and the RIGs for completion by the end of 2012.

4.4. We will shortly be publishing a consultation on additional financial incentives to sharpen the environmental considerations demonstrated by the TOs throughout the RIIO-T1 period. The key aim of the proposals we will be consulting on will be to drive companies to adopt a proactive corporate and operational culture to facilitate the transition to a low carbon energy. This is expected to complement the RIIO-T1 price control strategy for which the companies have proposed their investment and output delivery plans. We intend to publish our Final Proposals in this area in April 2012.

4.5. NGET and NGG are required to resubmit their business plans by 5 March 2012. We will consult on Initial Proposals for NGET and NGG in July 2012.

Appendices

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Appendix 1 - Consultation Response and Questions

1.1. Ofgem would like to hear the views of interested parties in relation to any of the issues set out in this document, the Supporting Document and the IA. In particular, we would like to hear from consumers and their representatives, gas and electricity transmission and distribution companies, generators and offshore gas producers/importers, suppliers, shippers, debt and equity investors, those with sustainable development interests, academics and other interested parties.

1.2. We would especially welcome responses to the specific questions which we have set out at the beginning of chapters 2 and 3 and which are replicated below.

1.3. Responses should be received by 20 March 2012 and should be sent to:

- RIIO.T1@ofgem.gov.uk

1.4. Unless marked confidential, all responses will be published by placing them in Ofgem's library and on its website www.ofgem.gov.uk. Respondents may request that their response is kept confidential. Ofgem shall respect this request, subject to any obligations to disclose information, for example, under the Freedom of Information Act 2000 or the Environmental Information Regulations 2004.

1.5. Respondents who wish to have their responses remain confidential should clearly mark the document/s to that effect and include the reasons for confidentiality. It would be helpful if responses could be submitted both electronically and in writing. Respondents are asked to put any confidential material in the appendices to their responses.

1.6. Next steps: Having considered the responses to this consultation and subject to the views provided Ofgem intends to publish Final Proposals for SPTL and SHETL in April 2012. Any questions on this document should, in the first instance, be directed to:

- Grant McEachran grant.mceachran@ofgem.gov.uk - Head of RIIO-T1
- 107 West Regent St, Glasgow, G2 2BA
- 0141 331 6008

CHAPTER: Two

Question 1: Do you consider that SPTL has put forward a business plan that is suitable for forming the basis of its price control settlement?

CHAPTER: Three

Question 2: Do you consider that SHETL has put forward a business plan that is suitable for forming the basis of its price control settlement?

Appendix 2 – RIIO-T1 Timetable

Phase	Year	Month	Milestone
Strategy Development	**2010**	**December**	Thursday 16th - **GEMA** - Decision on Strategy Consultation Friday 17th - Strategy Consultation Published
	2011		Thursday 17th - **GEMA** - Strategy Decision Mon 28th - Strategy Decision Published
Fast-Tracking		**July**	Friday 29th - T1 Business Plans Received
		October	Thursday 13th - **GEMA** - T1 Initial Assessment Monday 24th - T1 Initial Assessment Published
	2012	**January**	Thurs 19th - **GEMA** - T1 Fast Track Decision Mon 23rd - T1 Fast Track Update/Initial Proposals Published
		February	Mon 7th - T1 Fast Track Update/Initial Proposals Published Friday 17th - GD1 Initial Assessment Published
		March	Monday 5th - Final T1 Business Plan Updates Received
Initial Proposals		**June**	June - Committee Session - Initial Proposals
		July	Thursday 12th - **GEMA** - T1 and GD1 Initial Proposals Late July - Initial Proposals Published
		September	Late September - IP Consultation Closes
Final Proposals		**November**	Late November - Committee Session - Final Proposals
		December	Thursday 13th - **GEMA** - Final Proposals Decision Monday 17th - Final Proposals Published
Launch	**2013**	**January**	Stautory Consultation on Licence Mods
		March	New licences and RIGs issued
		April	Monday 1st - New Price Controls Commence

Appendix 3 – Summary of responses to October consultation

1.1. We received eleven responses to the October publication. None was marked as confidential.

Process

1.2. One respondent noted that the RIIO process was a significant improvement on the traditional price control processes. Another noted that the RIIO principles had encouraged the TOs to respond better to the challenges. Two respondents noted that the level of detail and transparency in the plans was better than previous reviews. Another respondent welcomed the reflection of developments introduced as part of DPCR5 in RIIO-T1.

1.3. Four respondents commented on Ofgem's assessment. One respondent considered Ofgem's grouping of the assessment criteria had provided a useful framework for scoring the business plans on a consistent basis. Another respondent supported both the process of conducting a filter process for determining which plans could progress through the fast-track process and Ofgem's judgement as it was best placed to identify which plans were candidates for the fast-track process. A third respondent was supportive of the process of providing iterative feedback to TOs during the fast-tracking assessment but supported Ofgem's statement that there would be no opportunity for revisions to ED1 business plans unless there was a clear justification for a fairly straightforward adjustment. The fourth respondent considered Ofgem's assessment had been generally proportionate and balanced but noted that there were some places where Ofgem's decision looked at odds with its assessment.

1.4. Two respondents commented on the decisions on specific plans. One respondent noted that it struggled to link the many sections of NGG's plan and thus supported Ofgem's decision not to retain NGG in the fast-tracking process. The other, a TO, welcomed being retained in the fast-tracking process and noted the ongoing work to address outstanding points in its business plan.

1.5. One respondent did not support fast-tracking and argued that Ofgem should conduct a full evaluation of all parts of the TOs plans on the grounds that:

- TOs are asking for considerable amounts which would have a significant impact on bills
- the plans are very detailed and require significant analysis to ensure they are reasonable
- any operating cost savings would not offset the additional risks to consumers
- SPTL and SHETL only have 'Red' and 'Amber' areas, neither are wholly 'Green'.

1.6. One respondent considered it important that there were clear benefits for companies of achieving fast-tracking. They noted that the arrangement should incentivise long-term benefits rather than encouraging short-term cost cutting arrangements.

1.7. Another respondent noted that changing parts of business plans may significantly impact other parts of plans. They argued the need for the company to deliver a coherent proposal overall and argued that the assessment should credit the overall package to avoid ‘cherry picking’.

1.8. Three respondents noted that being the first RIIO control this was a learning process for the companies and the regulator which would benefit future reviews. One of those respondents noted that it would be inevitable that areas of the RIIO principles would fall short of ideal and identified the following lessons:

- the timetable did not allow enough time to discuss key issues such as uncertainty mechanisms and annual price adjustments
- companies require in advance greater clarification of the well-justified business plan criteria and what information Ofgem will require in order to make a decision
- Ofgem should provide more detail on its decision making process for fast-tracking.

Stakeholder engagement

1.9. Two respondents welcomed the additional engagement undertaken by the TOs as representing a significant improvement. Another respondent recognised the significant time and effort TOs have put into engagement.

1.10. One respondent expressed concern that, where stakeholders’ views differ from Ofgem’s then those views would be discounted and cited the example of undergrounding. Another respondent noted that the priorities of stakeholders and TOs may not always be aligned and there would be value in co-ordinating RIIO work to support extended engagement.

Outputs

1.11. One respondent strongly supported the ongoing development of output regulation and considered that the development of comparative measure was the next step. They considered the failure to do so for RIIO-T1 made it difficult to compare the effectiveness of the plans.

1.12. One respondent raised a number of specific issues in relation to NTS connections:

- the development of a physical connection should be strictly linked with the release of commercial capacity and that this link was important to achieve the RIIO connections output
- the physical connection and capacity release processes should be linked to other third-party processes relevant to the success of the connecting project e.g. IPC, licensing

- it was not clear how the reopener for entry/exit capacity would practically work in the proposed phased-approach and that NGG should provide more details in this area
- it is not clear whether the income adjustment event mechanism has been considered to be rolled out over the RIIO control period.

1.13. One respondent noted that proposals to address Force Majeure, particularly given the circumstances around the Milford Haven pipeline construction, was missing from NGG's plan and should be reflected in a future draft. The respondent suggested that: (1) terms should go beyond basic capacity costs and that NGG should have progress report obligations where incremental capacity was expected to take longer than an "agreed" standard; (2) those obligations should be greater where NGG claim Force Majeure and (3) shippers should not pay for capacity that does not exist.

1.14. In relation to incentives, one respondent considered that particular attention should be focussed on the Demand Forecasting incentive where NGG have some control rather than areas where they do not have control eg short term storage, interconnector flows.

1.15. Two respondents supported the focus on network flexibility but both considered that further analysis was required by NGG to justify expenditure.

1.16. Three respondents commented on visual amenity issues and particularly on undergrounding. The key points respondents raised were:

- welcome the greater focus on visual amenity in the regulation of electricity transmission
- welcome increased engagement with and attention to the points raised by stakeholders in relation to matters of visual amenity
- need for greater alignment between Ofgem's decision making process and the Infrastructure Planning Commission (IPC)
- unclear what trigger mechanism should be for undergrounding but using the IPC would be beset with difficulty, should include socio-economic principles
- welcome the willingness to pay (WTP) analysis undertaken by Brunswick and the review of that study by London Economics as a valuable contribution to the debate but:

    - assumptions made on costs of undergrounding should be challenged
    - WTP did not distinguish between different landscapes for new lines
    - note the implication of the analysis is that WTP is at a level that would fund the undergrounding of all existing lines in AONB and National Parks
    - moving forward work should include focus group research and value transfer and revealed customer behaviour methods

- support for a volume-driver based uncertainty mechanism around investment in undergrounding put forward by NGET but regardless considered it unhelpful to specify a 10% limit in advance – one respondent noted this should be set much higher to ensure they are not exposed to this uncertainty, another noted that undergrounding cases such be judged on their own right and therefore the notion of an allowance was redundant
- concerned with the interaction with NGET's statutory duties in relation to being economic and efficient and question whether these duties would need revisiting

- support the principles outlined in the Treasury Green Book and consider that both NGET and Ofgem should adopt this approach as NGET's existing whole life cost approach was a black box, the respondents did not see any conflict between the public interest in the Treasury Green Book and consumer interests in Ofgem's statutory obligations
- the absence of a Strategic Environmental Assessment of network development is a major oversight
- not support NGET's matrix of unit cost allowances for undergrounding as it could inflate undergrounding costs causing inaccurate cost comparisons
- NGET could reduce planning risk and speed up planning consultations through innovation by accelerating work on alternative technologies e.g. gas insulated lines which could reduce the longer term costs of undergrounding
- support role for community compensation for loss of visual amenity via the developer entering into voluntary legal agreements to compensate communities.

Cost assessment

1.17. One respondent considered there should be further debate around alternative baseline scenarios – other than 'Gone Green' – that could deliver the 2020 targets.

1.18. Another respondent raised three points on the cost assessment:

- they expressed concern Ofgem had underestimated the work involved to connect low carbon assets and that an assumption that any cost increase would be inappropriate could result in short-termism and a failure to meet the 2020 targets
- they supported the focus on deliverability but noted that Ofgem should differentiate between outperformance through innovation and failure to deliver against output plans
- they considered that, to enable Ofgem to assess confidently the relative efficiency of plans, costs and volumes should be reported consistently across networks. They noted Ofgem's assessment had not demonstrated this had been achieved.

Efficient financial costs

1.19. One respondent did not consider that Ofgem's financial principles combined to form an acceptable package and that Ofgem had not included sufficient analysis to support its view. The respondent considered that Ofgem had not demonstrated the companies' financeability proposals were holistically inefficient but has looked at individual components in isolation. They expressed the following specific concerns:

- alternative capitalisation percentages had been dismissed without full consideration of customers' benefits
- the absence of metrics that recognise cash dividends paid and the narrow focus on overall measures of RORE over an 8 year period would not ensure that appropriate short and medium term returns were included in the packages
- cost of equity is a subjective subject and, given credible supporting evidence for a range above that put forward for RIIO-T1, this should be sufficient support for a proposal at the upper end of Ofgem's range
- depreciation policy may signal problems in later control periods given the inevitable decline in the FFO debt ratios and therefore Ofgem must consider the most efficient way of resolving long-term financeability issues.

1.20. One respondent expressed concern regarding the impact of some of the financial policy changes and provided the example of the cost of debt indexation exposing the company to significant interest rate risk when interest rates rise in the future. The same respondent noted that the level of revenue it had set out in its business plan was the minimum needed to ensure the cash flow delivered their target mid BBB/A credit ratios post risk.

Uncertainty

1.21. Five respondents commented on uncertainty. One considered that, given the scale of the business plans, alternatives where funding is provided outside the main price control allowance such as TII, should be considered. Another respondent set out that it would be counter-productive to attempt to develop novel and untried mechanisms, with potential unintended consequences, where existing mechanisms had been demonstrated to work satisfactorily.

1.22. The third respondent noted there were two key dimensions to the level of uncertainty associated with network decarbonisation. The first is volume uncertainty around the take-up of technology. The second is cost uncertainty associated with the application of embryonic technology and commercial solutions. The respondent considered that uncertainty mechanism should be applied that appropriately allocate risk without removing the incentive to bring forward innovative solutions.

1.23. The fourth respondent strongly supported Ofgem's position that all companies need to undertake further analysis on how charging volatility might be mitigated.

1.24. The fifth respondent recognised that NGG was facing significant uncertainty on transportation charges going forward and supported the role of an uncertainty mechanism to support a dynamic network. However, the respondent argued that there was need for a more fundamental consideration of the charging methodology under RIIO given: (1) the level and uncertainty of entry charges; (2) significance and lack of transparency of the "smearing" charge; and (3) the impact of those factors in making the price to end users less transparent. The respondent supported a change in the Entry/Exit split to 10/90 as providing more predictable, transparent and cost reflective changes to end users.

Appendix 4 - Feedback Questionnaire

1.1. Ofgem considers that consultation is at the heart of good policy development. We are keen to consider any comments or complaints about the manner in which this consultation has been conducted. In any case we would be keen to get your answers to the following questions:

1. Do you have any comments about the overall process, which was adopted for this consultation?
2. Do you have any comments about the overall tone and content of the report?
3. Was the report easy to read and understand, could it have been better written?
4. To what extent did the report's conclusions provide a balanced view?
5. To what extent did the report make reasoned recommendations for improvement?
6. Please add any further comments?

1.2. Please send your comments to:

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