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Dear Paul,

## **Assessment of the Distribution Price Control Review Process**

SSE welcome the opportunity to be able to participate in the review of the processes used by Ofgem during the recent distribution price control review (DPCR4).

Overall we saw clear improvements in the process from previous reviews, with much more transparency, a greater level of engagement and more policy issues resolved earlier in the process. However, there were a couple of areas that didn't go so well, for example a lack of focus in the data requests; and there are therefore a few learning points for future reviews. Whilst our detailed comments on the general process issues are provided in the attachment, it is useful to discuss the general principles and objectives of the review here, along with our assessment of process delivery.

SSE consider that the main objectives of the review were appropriate and, in the main, were met by Ofgem. However, as noted above, whilst there were more policy issues resolved earlier in the process, there were still key issues such as RAV that were not resolved until the very end of the process. In our view, this resulted in a greater degree of uncertainty than was necessary.

SSE strongly believe that the RPI-X price control mechanism remains relevant for monopoly wires businesses. The price review process has developed over time, with improvements evident at each review. Potential improvements to the process for the next review include better focus on what information is required and what it is to be used for and an early decision on other key policy issues. We also firmly believe that annual approval of the RAV would reduce uncertainty. Finally, we believe that a number of aspects of the price control proposals were unnecessarily complicated, particularly in relation to new incentive schemes (e.g. distributed generation). We would in future reviews urge Ofgem to minimise the degree of complexity of the price controls and associated reporting.

In summary, we believe that the process worked well and produced a price control in a cost efficient manner. The main positive points coming out of the review were the development of the working groups, improved access to both Ofgem and the Authority and greater certainty with more policy issues resolved earlier in the process. What didn't go so well was the preparatory work of the network review project, the

significant amount of information requested (which was not then used in the review) and some key issues still outstanding at the final proposals stage.

I hope these comments are helpful, if you wish to discuss any of the points raised in this letter further, please do not hesitate to contact me.

Yours sincerely,

Rob McDonald  
**Director of Regulation**

## **SSE Detailed Comments on the Distribution Price Control Review Process**

### ***Communication***

In general the channels of communication during the review process were effective. There was ample opportunity to engage with Ofgem throughout the process and the workshops and working groups, discussed further below, all worked well. We found the formal meetings with the Authority useful at the three key stages of the review.

However there is still room for improvement. At each key stage of the process there was an unexpected development: with the first policy paper, Ofgem introduced the concept of the ‘vanilla WACC’; at the second, new proposals for the treatment of tax were introduced. Furthermore, in the final proposals new regulatory concepts were introduced which had not previously been consulted upon in detail (in particular the selective use of the opex roller for some companies, but not others, and the additional cash for seaboard financing).

We believe that there are two key lessons arising from this. First, it is vital that we receive the detailed audit trail of Ofgem’s calculations at the same time that we receive the proposals documents. This would have helped significantly in understanding Ofgem’s policy and would have produced better-informed discussions.

Second, we believe that there should be few, if any, “new” policies introduced at the final proposals stage of the process.

### ***Workshops***

SSE found the workshops useful, particularly the *ad hoc* ones arranged to address specific issues. This flexibility is welcomed.

### ***DNO/Ofgem Working Groups***

The working group structure is a welcome addition to the review process and, in general, provided useful and meaningful outcomes. However, the process could be improved by the introduction of a co-ordination group attended by Regulation Managers to better co-ordinate the work of the other groups. Formal minutes of all meetings would also help to improve the linkage between the groups.

### ***Preparatory work***

In contrast to the development of the workshops and working groups, the preparatory work was not a success. The Developing Network Monopoly Price Controls project, whilst successfully setting out the objectives of the review, failed to deliver on some key objectives. For example the opex roller, promised as part of the network price control review, failed to materialise and the development of the Regulation Accounting Guidelines stalled at draft 16.

A key learning point here is that complex issues are better addressed by simple, pragmatic solutions rather than complex ones.

### ***Use of consultants***

Overall SSE do not believe that the use of consultants provides good value. Whilst it is understood that external technical expertise is required in some areas, it would be preferable if Ofgem were able to develop in-house expertise for the key areas of the review. This, we believe, would reduce information requests, aid integration of the price control building blocks and improve transparency. This does not mean that consultants will never be required, particularly in relation to capex, but a reduction in reliance on consultants would in our view be more cost-effective.

### ***Consultation process***

We believe that the consultation process, at 18 months from the network review workshop to the final proposals document, was too long. Going forward the process could be shortened in a number of ways. Examples are:

- be clearer at the beginning of the review on what information is required. This is discussed further below;
- the use of in-house expertise, as discussed above, would reduce some of the information requests, improve efficiency and thus reduce time.

Whilst, in most instances our proposals during the consultation process were considered by Ofgem, some we made were not responded to or addressed. If an opposing or alternative view is put forward, it would be helpful to understand why this has not been accepted by Ofgem.

Finally on this topic, whilst more policy issues were resolved earlier in the process this time round, there is still room for improvement. Key building blocks such as the RAV and Cost of Capital in our view need to be addressed much earlier in the process, in the interests of minimising regulatory uncertainty. In particular, there would appear to be no reason why, going forward, the RAV could not be approved annually. We also believe that Ofgem could have done more, earlier, to set a floor or a narrower range around the Cost of Capital before the final proposals stage.

### ***Requests for, and use of, information***

SSE found the requests for information overly burdensome. Furthermore, we would question whether use was made of much of the historic information provided to Ofgem and/or their consultants.

There were also examples during the review of multiple requests for the same information. This places additional burden on already stretched resources during the review process. More thought is therefore required on the use of information/data. If the review models are built earlier in the process, with industry involvement, then the data request for the FPBQ will be much better focussed. Thus, for the future, we would suggest that requests for information need to be much better targeted.

With the advent of the RRP, information requests can be minimised and indeed we would not expect an HBPQ to be required. Furthermore, whilst the RRP will provide Ofgem with a significant amount of information, it will be essential to remember that effective comparative analysis requires a relatively high level view of operating and capital costs. There is a risk that Ofgem could get stuck in the minutiae of the RRP.

Provision of the RRP information on an annual basis should also allow Ofgem to agree the RAV annually. SSE strongly advocate this, as it will help to reduce uncertainty and shorten the timescale of future reviews.

### ***Timeline***

As noted above, a number of key building blocks for the review were not addressed until very late on in the process. For example, the impact of changes in the tax regime were still being finalised in September 2004 whilst the RAV and Cost of Capital were not finalised until the final proposals at the end of November 2005.

SSE believe that the timeline for future reviews could be shortened. With the advent of the RRP there is no requirement for anything like the network review preparatory work, nor indeed for an HB PQ.

### ***Regulatory consistency***

In general we found the consistency throughout this review much improved over previous ones. However, as we have noted above, at each major stage of the process there were unexpected developments. We would hope that for future reviews these could be minimised by addressing key policy issues much earlier in the process.

### ***Transparency***

SSE consider that there was a significant, positive, change in the level of transparency from previous reviews and this is to be welcomed.

### ***Access to Ofgem & the Authority***

Access to Ofgem and the Authority was also much improved. In particular, we welcome the introduction of formal meetings with the Authority at key stages in the review.

### ***Further Work***

The ongoing work with respect to cost reporting should enable the RAV to be agreed year-on-year. As discussed above this should obviate the need for a HB PQ.

Network resilience is likely to become a major cost driver in the future. It is essential that the transparency and engagement between Ofgem and the DNOs, that worked well for the price review, is maintained for this important area of work.

Finally, with regard to financeability, we are not sure that the link between this work stream and the DPCR is clearly defined. We would welcome Ofgem clarifying the work that is being undertaken and how it will feed into DPCR5.

### ***Other Issues***

Whilst the Ofgem consultation is rightly focused on process, there is one work area that we do wish to comment upon. This is metering.

DNOs raised their general concerns about the process difficulties evident in this work area at the DPCR Workshop in March 2005. We would wish to reinforce these concerns: there was certainly a lack of focus on this work area with it being separate from the main price control activity. A learning point for future reviews is to ensure

that all aspects of a price review, however dis-aggregated, must have an appropriate level of attention and need to be co-ordinated with other workstreams.