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Dear Hannah,

Regulating energy networks for the future: RPI-X@20 recommendations Impact Assessment

In addition to our response to the main ‘Regulating energy networks for the future: RPI-X@20 recommendations’ consultation document, SSE welcomes the opportunity to respond separately to the Impact Assessment. While we recognise that the assessment has been undertaken at a high level and hence is not comprehensive, as we describe below, we believe that there are material issues with the assessment that potentially overstate the benefits and understate the downside risks of the RPI-X@20 recommendations.

There are two main assumptions underpinning the approach taken by Ofgem in carrying out the impact assessment which, in our opinion, undermine the value of the assessment. Firstly, a generic approach has been taken which precludes consideration of the significant differences across the networks of the impact of the recommendations. This is most important in respect of the proposed financeability changes. The different networks already have different financeability frameworks. Hence, changes to, for example, deprecation and capitalisation policies will have very different impacts on the different networks.

Further to this, there has been no overall quantitative assessment of the risks attached to the RPI-X@20 recommendations; it appears that the best case scenario has been considered, while the worst case has not. The most significant example of this is with regard to the cost of capital. It is acknowledged in the RPI-X@20 recommendations that some of the recommendations – for example, the longer term price control and the ‘fast track’ process – will increase the risk to the networks. In our view, the financeability proposals, by reducing cashflows will also significantly increase regulatory risk. One response to this increase in risk is an increase in the cost of capital. However, the impact assessment looks only at the potential impact of a reduction in the cost of capital; we would therefore question whether the assessment provides a balanced view.

In addition to these main assumptions, we also have concerns about the value of this assessment in respect of:

§ The scope of the assessment. For example, the recommendations regarding the third party right of appeal have been identified by all parties involved in the RPI-X@20 review (including Ofgem) as having the potential to cause significant delays to the implementation of all or part of a price control. The assessment does not consider the impact of this.

§ The basis for some key assumptions. For example, the potential savings to be made by involving third parties in delivery are based on a 10-20% efficiency assumption which appears to be derived from specific case studies, with variable conclusions, undertaken by the NAO and others in the 1990's and published in 2002. In its 2009 update to the 2002 report, the NAO conclude "Our long-held view on PFI is that it is neither always good value for money, nor always poor value for money. It has the potential to deliver benefits but not at any price or in any circumstances. In practice its value is contingent on a wide range of contract, sector and market specific factors". Given this, it would appear necessary, at the very least, to give specific consideration to the comparability of this outdated, tentative analysis to the highly specialised nature of large capital projects in the privatised energy sector.

§ Unsupported statement of potential efficiency gains. Examples include the assumption that enhanced stakeholder engagement and a longer term price control would automatically result in efficiency savings. While we are broadly supportive of these proposals, it is not clear to us that these proposals will necessarily lead to significant efficiency savings.

Both individually, and taken together, these assumptions significantly undermine the value of the impact assessment. Given these concerns, we cannot concur with Ofgem's conclusion that the RPI-X@20 recommendations could lead to a lower increase in consumer bills of £1 billion in the next eight years. We note that the majority of Ofgem's assumptions tend to be optimistic and, hence, believe that the downside risk has not been fully explored; in particular with regard to the impact of Ofgem's proposals on financeability.

I hope the above is helpful. If you have any questions please be in touch.

Yours sincerely,

Rob McDonald

Director of Regulation