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Dear Peter,

### **Open letter consultation on the regulatory asset lives for electricity distribution assets**

SSE is strongly opposed to both the principle and justification put forward for the proposed change to the regulatory asset lives for network assets. We have already set out our position in our response to Ofgem's RIIO-T1 and GD1 strategy consultation: the majority of these arguments also stand in relation to our distribution licensees.

Regulatory asset lives are not the same as statutory asset lives or economic asset lives. This is a long held principle of GB economic regulation. Regulatory asset lives are a complex financial instrument designed to spread the costs of network assets across both current and future customers. Ofgem's proposal to more than double the period over which these assets are remunerated will mean that future customers will end up paying more than their fair share. In an industry facing the potential for considerable change and new investment, this does not seem prudent.

Moreover, by extending the regulatory asset life, Ofgem seems to assume greater confidence that these same assets will be in use 45-55 years from now. This seems to wholly contradict measures being taken elsewhere to encourage and enable the DNOs to innovate to ensure that they are able to deliver the networks needed to move to a low carbon economy. It also seems to contradict the drive towards more commercial, demand-side management solutions, which we would expect to be less enduring than the more traditional capex approaches. Therefore, we would argue that it is even questionable whether today's assets will still be around in 20 years. Whilst Ofgem acknowledges this uncertainty in its open letter, the fact that it is considering a proposal to lengthen regulatory asset lives to 45-55 years seems to be at odds with this.

Importantly, inextricably linked with any decision to lengthen regulatory asset lives is an increase in the financing cost and the associated risk premium. Longer regulatory asset lives lengthen cash flows and lengthen returns. This unavoidably reduces investor confidence: an investor will almost certainly be less confident about being remunerated over 50 years than it will over 20 years. Changes in the regulatory framework are just one example of why this

would be the case. It is not possible to give any guarantees that there will not be a review of RIIO 20 years from now. The adverse impact on investors created by this real regulatory change proposal and the concern that this introduces over future changes must not be underestimated. This increased risk can only increase the cost of equity and allowances must be made for this.

In responding, we have considered what the impact of moving to a regulatory asset life of 50 years would have been on the DPCR5 settlement for our two licensees, all else being equal. Our analysis shows that SSEPD's base revenue across its two licensees during the five-year period would have been three-quarters of what was actually agreed. On an industry-wide basis, the reduction in revenue would be staggering. Our analysis also shows the impact on SHEPD and SEPD's free cashflows: this change in the regulatory asset life pulls both licensees from a positive free cashflow position to a negative one. This affects our ability to make dividend payments, which in turn discourages investors. All this is at a time when Ofgem is asking network companies to actively change their networks to position themselves for a low carbon economy.

For the avoidance of doubt, we do not support a change to the regulatory asset lives in electricity distribution. We believe Ofgem's proposal to extend the regulatory asset lives for distribution in isolation, which is the basis on which this is currently being put forward in distribution, is wholly unworkable. CEPA's failure to consider the additional financing costs associated with the lengthening of cash flows and returns is a fundamental omission in its analysis.

If, despite this position and the position of the industry, Ofgem progresses with its proposed change to distribution regulatory asset lives, then it must take offsetting steps to maintain the status quo. Such a fundamental change could only be implemented if steps were taken to maintain the current position in terms of cashflow and address the increased risk to investors through the cost of equity. We agree that a straight line depreciation profile is the most appropriate to ensure that costs are spread evenly: the mechanism should not start to pre-empt which customers benefit most. Therefore any impacts of a change in the regulatory asset lives must be reflected in other financial parameters, not least the cost of equity. The discussions to date in relation to RIIO-T1 and RIIO-G1 do not instil confidence. We believe it is important that we meet investors' expectations for adequate remuneration over a reasonable time period. In our experience, this means being able to make dividend payments within the price control period.

Should you wish to discuss any of the above in more detail, please do not hesitate to contact me.

Yours sincerely,

Aileen McLeod  
**Head of Network Regulation**