

Hannah Nixon
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Ofgem
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Dear Hannah

RIO-T1 Transmission companies' business plans

Our detailed comments on the transmission companies' business plans are set out in the attachment to this letter. The key points of our response are:

- We welcome the new RIO model, which aims to generate increased stakeholder engagement. However, it is possible that the considerable amount of information provided in the four business plans might not have achieved the aims of information clarity and customer engagement.
- One important justification for the RIO-T1 model was to enable the Transmission Owners (TOs) to outline their revenue requirements for investment and deliver outputs for stakeholders. We would have expected the business plans to clearly set out the scope of work that the TOs intend to undertake but we have been unable to identify this.
- A five week window within which we are able to provide comment on the business plans should be reviewed and be consistent with the amount of information provided.
- A possible alternative approach for future business plan publications would be to issue executive summaries in a standard format, containing the information likely to be required by stakeholders to respond to any Ofgem review. The introduction of a word limit may also aid in the production and review of future business plans.

Should you wish to discuss any of the issues raised in our response or have any queries please contact my colleague Rob Rome on 01452 653170, or myself.

Yours sincerely,



Denis Linford
Corporate Policy and Regulation Director

Attachment

RIO-T1 Transmission companies' business plans

EDF Energy's response

Overall quality of the plans

*Do you consider that the plans are comprehensive and well-justified so they provide a clear understanding of what the company will deliver over the price control period?
Do the plans include all relevant information necessary for you to understand the impact of those plans on your interests?*

The price control has a significant impact on our business as it has a direct impact on the costs we face, as well as the ability to safely transmit energy to our customers. We have devoted considerable resource in an attempt to ensure that the price control delivers an appropriate level of investment at minimal cost to consumers. However, the level of detail and documentation provided on many of the measures has hindered our ability to analyse and comment on the proposals.

To be specific, the business plans are extremely lengthy documents and there does not appear to be an executive summary or a concise summary of the expected investments that the TOs expect to undertake.

A possible alternative approach for future business plan publications would be to issue executive summaries in a standard format, containing the information likely to be required by stakeholders to respond to any Ofgem review, which should include a clear and concise investment plan. This could also be combined with a stakeholder event allowing the TOs to outline their business plans at a high level and respond to questions that stakeholders may have. The introduction of a word limit may also aid in the production and review of future business plans.

We would like to see a concise plan outlining the investments that the TOs intend to undertake and their timelines for delivery. NG undertook significant work to develop the Electricity Scenarios Illustrator (ELSI) model so that stakeholders could run different scenarios, in part, to better understand the value of strategic investments identified by the Electricity Networks Strategy Group (ENSG). We supported this work and found that the models were very useful, although noted that further development would have been beneficial.

Reflecting what customers value / stakeholder engagement

*Have the views that you provided to the network companies been reflected in their plans?
Do you consider that the plans reflect the interests of both existing and future consumers?*

Detailed scenarios and models have been made available to engage stakeholders before the submission of the transmission companies' business plans. We have previously stated that additional explanation is needed to enable stakeholders to gain real understanding from this information; we have not seen any information regarding this in the companies' plans for ongoing engagement. This should be an important learning point in stakeholder communication.

Investment Plans

Do you consider that the companies have clearly identified and justified revenue allowances in their business plans to cover their network investment requirements?

It is widely recognised that the level of investment required in the electricity transmission system is significant as the TOs seek to replace ageing assets and support the move to a low carbon energy sector. This requires the connection of new generation as well as the replacement of existing plant as it comes to the end of its economic life. Therefore, National Grid's (NG's) proposed investment plan of £16.8 billion over the price control period appears appropriate.

Given the drivers for change in the electricity system, the investment required and the existing constraints, there appears to be a wide recognition that NG should be allowed adequate funding to build network and incur an efficient level of constraints. There is also a need to fund strategic investment to avoid future constraints. The publication of the electricity scenarios model (ELSI) seemed to confirm the need for strategic investment.

However, the business plans submitted by NG have not clearly demonstrated whether the company expects to undertake certain investments or not, e.g. the Eastern HVDC link.

For gas, there is recognition that although Great Britain now needs to accommodate a wider and more diverse mix of gas supplies, there is a perception that there is sufficient capacity within the existing infrastructure. The investment requirements of NG would therefore be expected to focus on maintaining reliability and replacing ageing assets. In this context, a forecast expenditure of £6.7 billion might be higher than the industry was expecting.

Financial proposals

Do you have any views on the package of finance measures proposed by the companies?

The documents presenting the financial measures proposed by NGET and NGG are extensive, amounting to 260 pages. We have therefore chosen to review the proposals based on the key issues that we identified at the strategy stage, rather than completing a detailed review of the entire submissions.

In relation to the financial proposals, we make the following high level comments:

- We remain unconvinced that the proposed equity beta of 1.0 is appropriate. An equity beta of 0.8 would appear generous when compared to the statistics published by a number of financial analysts.
- NG and the Electricity Networks Association (ENA) have commissioned Oxera to produce a study looking at the cost of debt that suggests a premium of 10 basis points should be added to the risk free debt index. However, this is not publicly available on NG's RIIO website and we have not found supporting evidence to allow us to confirm the appropriateness, or otherwise, of NG's proposed approach to the cost of debt.
- We remain unconvinced that a move from a 20 year to 45 year depreciation policy should be spread over two price control periods as opposed to one price control period as proposed by Ofgem.

Focus on sustainability

Do you consider that the companies' plans set out an appropriate strategy that they will employ to play a full role in delivering a sustainable energy sector?

Transmission companies face a significant task in the connection of new sources of low carbon generation. The management of intermittent generation will also present an additional challenge to NG. There are statements in NG's business plan which refer to the need for a focus on the environmental impact of its activities, but with little detailed, practical information on how this will be achieved.

NG states it is unlikely that any commercial solution will be available for SF6 leakage reduction during the period of the RIIO-T1 price control period. It appears unfortunate that the reduction of leaks of this potent greenhouse gas has not been prioritised. It could be argued that when delivering its environmental output it is NG's overall impact on the environment that should be measured. This should include SF6 emissions and we would expect NG to take the most efficient actions to reduce their impact on the environment.

Uncertainty and risk

Do you consider that the plans present a comprehensive consideration of the sources of uncertainty they face, their potential impact on output delivery and a clear strategy for seeking to address uncertainty in the long term?

The RIIO-T1 price control covers a period of significant investment required to move towards a low carbon economy, which presents additional risks to the transmission companies.

The internal risk management reporting approach that NG has set out appears reasonable and the Combined Code Turnbull Guidance is recognised as good practice. The approach captures a wide range of the risks faced; and it would appear that NG is best placed to judge whether this list is comprehensive.

It is appropriate for any business plan to identify the possible risks to successful delivery, with appropriate incentives to fund mechanisms to manage this. The balance of risks shared between the transmission company and the consumer needs to be correct.

We note that the document contains a number of references to further work still to be undertaken. We also note that in the finance appendix it states that the modelling does not reflect any changes in six listed risks. We anticipate access to further information regarding any additional work or changes to the modelling undertaken.

EDF Energy
September 2011