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To generators, shippers,
suppliers, network companies,
consumers and their
representatives, the sustainable
development community,
investors and other interested
parties.

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Date: 24 October 2011

Dear colleague

Initial assessment of RIIO-T1 business plans and proportionate treatment

This letter summarises our assessment of the four transmission companies' (TOs') business plans for the next price control period, RIIO-T1.¹ In light of that assessment, it also sets out which companies we are retaining in the "fast-tracking" process at this stage and, for those that we are not retaining in that process, which elements of their plan are of sufficient quality that we can apply proportionate treatment to them. We provide more detail on our assessment in a supporting annex entitled 'Initial assessment of RIIO-T1 business plans'.² We are also publishing a report by London Economics to support part of our environmental assessment.³

We welcome views on any aspect of this assessment. We will consider views as part of our further assessment of the companies' plans. Please submit any written comments to RIIO.T1@ofgem.gov.uk, by **Monday 21 November 2011**. Unless clearly marked as confidential, responses will be published on our web forum.

Please contact grant.mceachran@ofgem.gov.uk if you would like to discuss any of the issues in this letter.

Background

Last October we introduced RIIO (Revenue = Incentives + Innovation + Outputs), our new approach to regulating Britain's gas and electricity network companies. RIIO is designed to drive real benefits for consumers; providing network companies with strong incentives to step up and meet the challenges of delivering a low carbon, sustainable energy sector at a lower cost than would have been the case under our previous approach.

A key principle of RIIO is for companies to develop a well-justified business plan through enhanced stakeholder engagement. 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. Fast-tracking provides strong incentives for the companies by allowing them to conclude their price control up to a year ahead of the standard timetable.

¹ RIIO-T1 will cover the 8 years commencing 1 April 2013.

² <http://www.ofgem.gov.uk/Networks/Trans/PriceControls/RIIO-T1/ConRes/Documents1/busplanannex.pdf>

³ <http://www.ofgem.gov.uk/Networks/Trans/PriceControls/RIIO-T1/ConRes/Documents1/visualamenity.pdf>

In March 2011, we set out our strategy for RIIO-T1⁴. This set out decisions on the key aspects of the regulatory framework, including the outputs that the transmission companies need to deliver and associated incentives, mechanisms to address uncertainty during the price control and the key elements of the financial framework. It also set out what we expected to see in a well-justified business plan and the criteria against which we would assess the plans. The TOs submitted their business plans to us in response to this at the end of July, and published them on their websites⁵.

For a company to remain in the fast-track process, we need to have a reasonable expectation that the company is willing and able to resolve any outstanding issues within the required timescales. This means in time for us to determine which companies are ultimately fast-tracked in April 2012 following consultation on fast-track initial proposals in January 2012.

As this is the first implementation of the RIIO framework, it is a learning experience for us, the network companies and the wider industry. We recognise that this is the first time that companies have had to produce business plans under the RIIO framework and that RIIO requires a significant mindset change from the TOs. As set out in our March strategy document, we are therefore providing for greater iteration between the first business plan submission and our fast-track decision than we intend to do in the future. Importantly, this does not mean that we are lowering the bar for a company to be fast-tracked.

Our decision on which companies are retained in the fast-track process does not therefore necessarily reflect our view on which plans are the highest quality at this point in time. Our decision reflects our view of which companies are willing and able to resolve the outstanding issues in the time available, taking into account the scale of work required.

Our assessment of RIIO-T1 business plans

The business plans submitted by the TOs clearly demonstrate that they have responded positively to the RIIO framework. All of the TOs have sought to engage actively with their stakeholders in developing their plans. All have also made strides towards developing plans that are outputs-led and reflect the consideration of stakeholders' views. They also demonstrate how they have taken account of a wider range of issues, including their role in contributing to delivering a sustainable energy sector and the risk and uncertainties associated with delivering their plans. They have all published significantly more information than they have in any previous price control process.

However, there are a number of areas requiring further work in all of the plans which include, but are not limited to, the need to provide greater evidence of an overarching strategy to deliver environmental responsibilities, the need for more detailed innovation strategies and the requirement to provide further information and review and revise elements of their financial proposals.

We have undertaken an initial assessment of the business plans. This is summarised in Table 1 below and set out in more detail in the supplementary annex to this paper.

The main conclusion of our assessment is that none of the plans are suitable for fast-tracking in their current form; although all four plans have strong areas that are suitable for proportionate treatment. These are areas of the plans we have assessed which are already broadly acceptable to us.

Since the publication of their plans all of the TOs have engaged constructively with us in discussing issues with their plans. This has included meetings at a working level, with our

⁴ Decision on strategy for the next transmission price control: RIIO-T1 – Ofgem, 31 March 2011 #46/11 <http://www.ofgem.gov.uk/Networks/Trans/PriceControls/RIIO-T1/ConRes/Documents1/T1decision.pdf>

⁵ Links to the TOs' plans were provided in our August 2011 consultation letter which sought view on those plans <http://www.ofgem.gov.uk/Networks/Trans/PriceControls/RIIO-T1/ConRes/Documents1/RIIOT1busplans.pdf>

Committee of the Authority and with the Consumer Challenge Group⁶. We have used the additional information gleaned through these meetings to consider the work involved in resolving outstanding issues. As indicated in Table 1, in a number of instances we believe that the TOs could resolve the outstanding issues in a timeframe consistent with fast-tracking. In the table:

- 'Green' denotes aspects of companies' plans that are broadly acceptable to us
- 'Amber' denotes areas where we need more information
- 'Red' denotes aspects of companies' plans that are not acceptable to us.
- 'R' denotes aspects which, in light of further information, may be resolvable in the timescale consistent with fast-tracking.

Table 1: Summary of assessment of TOs business plans⁷

Category	NGET	SPTL	SHETL	NGG
Process		R	R	
Outputs		R	R	
Resources – efficient expenditure		R	R	
Resources – efficient financial costs	R	R	R	R
Uncertainty/Risk	R	R	R	R

Decision on proportionate treatment

National Grid Electricity Transmission (NGET)

For NGET there are significant positives in their plan, most notably their detailed stakeholder engagement processes, their approach to risk assessment and risk management and their coverage of safety. We intend to apply a proportionate level of scrutiny to these areas of NGET's plan.

In many ways NGET provided the most comprehensive coverage of the required elements of a well-justified business plan. However, there are significant issues to address in their plan. The key issue is that this is a complex plan and there are a number of inconsistencies in the way the data was presented in the data templates provided by NGET alongside their plan which make it difficult to assess important aspects of the detail of their plan. There were a number of other issues in NGET's plan to be addressed such as clarification on which projects would be funded through the wider works uncertainty mechanism, further information on physical security costs and providing further information and reviewing and revising elements of their financial proposals. Further information on these issues and the other aspects of NGET's plan is set out in the supplementary annex to this letter.

We held constructive discussions with NGET on how to take these issues forward. While a number of these issues could be addressed, the scale of required work to address the inconsistencies in the data templates is too significant to enable resolution before our fast-tracking consultation. On this basis, **we are not retaining NGET in the fast-tracking process.**

National Grid Gas (NGG)

For NGG there are significant positives in their plan most notably their comprehensive coverage of the required content and detailed stakeholder engagement processes, their approach to risk assessment and risk management, their coverage of safety and connection outputs. We intend to apply a proportionate level of scrutiny to these areas of NGG's plan.

⁶ The CCG which comprises consumer and environmental experts acting as a critical friend to Ofgem in the RIIO-T1 and RIIO-GD1 processes.

⁷ In a few areas of the assessment a TO's performance was identified as being between Amber and Red or between Amber and Green. We have identified these areas with appropriate shading.

There are key issues to address in their plan including inconsistencies in their data templates and further evidence relating to any proposed network flexibility expenditure required. There are other issues in NGG's plan to be addressed such as the requirement to provide justification for the planned compressor replacement programme and providing further information and reviewing and revising elements of their financial proposals. Further detail on these areas is set out in the supplementary annex to this letter.

We held constructive discussions with NGG on how to take these issues forward. While a number of these issues could be addressed, the scale of required work to address the network flexibility and data inconsistencies is too significant to enable resolution before our fast-tracking consultation. On this basis, **we are not retaining NGG in the fast-tracking process.**

SP Transmission Ltd (SPTL)

The key positives in SPTL's plan are its coverage of safety, the quality of the completion of its data tables and elements of their technical financial proposals. We intend to apply a proportionate level of scrutiny to these areas of SPTL's plan.

SPTL has a wide range of issues to address. These include providing evidence of cost efficiency throughout the plan, considering the impact of existing infrastructure on visual amenity, providing further information on a number of the outputs including connections and reliability and providing further information and reviewing and revising elements of their financial proposals.

While there are a number of issues for SPTL to address, the company has demonstrated that the scale of these might allow them to resolve these in a timeframe consistent with fast-tracking. On this basis, **we are retaining SPTL in the fast-tracking process.**

Scottish Hydro Electric Transmission Ltd (SHETL)

The key positives in SHETL's plan include the overall tone of the plan which was clearly focused at stakeholders and the coverage of its safety and connections outputs. We intend to apply a proportionate level of scrutiny to these areas of SHETL's plan.

SHETL has a wide range of issues to address, these include providing evidence of cost efficiency throughout the plan, considering the impact of existing infrastructure on visual amenity, providing further information on a number of areas of their outputs and providing further information and reviewing and revising elements of their financial proposals.

While there are a number of issues for SHETL to address, the company has demonstrated that the scale of these might allow them to resolve these in a timeframe consistent with fast-tracking. On this basis, **we are retaining SHETL in the fast-tracking process.**

Next steps

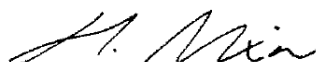
This decision does not mean that SPTL and SHETL's plans will automatically be fast-tracked. The onus is on those companies to resolve the outstanding issues in time to enable us to consult on fast-track initial proposals for those companies in January 2012. This is a slight change to our previous timetable in which this consultation was due to be published in December 2011. The additional time is intended to allow the maximum possible time to allow outstanding issues to be resolved. We will publish our decision on fast-tracking and, if SPTL, SHETL or both are ultimately found suitable for fast-tracking, set out final proposals for those companies in April 2012.

If the companies do not meet the required standard in the applicable timeframe then they will revert to the non fast-tracked timetable. Even if none of the four TOs are ultimately fast-tracked there is still a strong incentive for them to address outstanding issues to reduce the number of areas of their plans that require more detailed scrutiny.

Over the next few months we will continue to engage with all of the TOs to provide further feedback on their plans. In the case of SPTL and SHETL we will focus on the issues that need to be resolved for the companies to be suitable for fast-tracking. In the case of NGG and NGET the engagement will focus on addressing the issues required for the further submission of their business plans in March 2012.

There is an important role for stakeholder engagement at this stage of the process. We expect all TOs to engage further with their stakeholders to inform the areas for further development in their plans. In particular, it will be important for the TOs to focus on stakeholders who have been underrepresented in the engagement process to date or have specific issues which they do not consider have been addressed to date. We will also continue to engage with interested parties and welcome the continued input from all stakeholders on all aspects of this process.

Yours sincerely

A handwritten signature in black ink, appearing to read 'H. Nixon', written in a cursive style.

Hannah Nixon
Acting Senior Partner, Smarter Grids and Governance