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Dear Hannah,

Open letter consultation on the way forward for the next electricity distribution price control review – RIIO ED1

Scottish and Southern Energy Power Distribution (SSEPD) welcome the opportunity to comment on Ofgem's open letter consultation on the way forward for the next electricity price control review.

Summary of our views

SSEPD believes that the regulatory settlement established through RIIO ED1 should:

- Continue to reward DNOs for operating at the frontier of efficiency. Since privatisation, significant customer benefits have been achieved through the regulatory focus on operating and capital efficiency. It is essential to retain this focus. We consider that the measure for efficiency should be assessed across all totex and apply a consistent methodology to setting the price control and monitoring performance;
- Clearly define what customers, wider stakeholders and Ofgem mean by 'new innovation' and 'business as usual' activity, with the focus on translating innovative developments into cost effective business as usual in a timely manner. To achieve this, RIIO ED1 should continue to provide incentives for DNOs who are innovative and deliver customer benefits through making their networks smarter;
- Encourage a whole life approach to asset maintenance and investments. RIIO ED1 should support active network management as a means of deferring investment until it is actually required;
- Incentivise DNOs to achieve excellent environmental performance and establish formal outputs and reward/penalty mechanisms that will encourage this behaviour. In addition, we consider that RIIO ED1 should continue to reward good performance on quality of supply and customer satisfaction;

- Be customer-led and incorporate a social obligation output that measures the contribution of DNO investment activities to local, regional and national community development; and
- As far as possible, be simple and easy for DNOs, stakeholders and customers to understand. The perceived complexity of the industry is a common theme from our customers. Going forward, engagement with customers will be central to the successful adoption of lower carbon networks. We consider that RIIO ED1 and the associated regulatory framework provide an opportunity to reduce, where appropriate, the complexity of setting price controls. The fast-tracking of business plans assists in this process, and the level of information required from DNOs should be proportionate with that required for fast-tracking business plans.

The portfolio of our electricity distribution assets, and their strategic importance to the British economy, means that RIIO ED1 will have a significant impact upon our business and the way we deliver the expectations of our stakeholders during the period 2015-2023. We are therefore committed to working proactively with Ofgem and our stakeholders to ensure that appropriate incentives exist for DNOs to meet the needs of their customers across the next price review.

Our responses to the specific questions raised in Ofgem's open letter are discussed in more detail below.

Low carbon technologies and smart grids

SSEPD agrees that low carbon technologies and the development of smart networks should be a focus for RIIO ED1. We therefore agree with Ofgem that the next price control period must incentivise and reward DNOs for the timely and cost effective development and accommodation of low carbon technologies.

Given the rapidly evolving nature of low carbon technologies, we think it important for the industry to clearly define what is considered to be 'new innovation' and what is 'business as usual' activity for DNOs. We are currently of the view that there is uncertainty across the sector on this point, and a common view would be useful to help customers understand how networks are evolving to meet their needs.

We also consider that there needs to be a greater emphasis on turning innovation projects into business as usual, and specific rewards should be made available to DNOs in RIIO ED1 to achieve this.

SSEPD also consider it important that Ofgem does not prescribe the technology to be used in making our networks smarter. In this respect, we welcome the focus in RIIO ED1 to establish outputs not inputs.

Demand side management will be essential but limitations may exist depending on how this is implemented, particularly where suppliers take an active role in the provision of these services and the impact this may have on networks. It will therefore be important for the right economic signals to be established from the outset of RIIO ED1.

What is also important, especially given the proposed duration of the next price control, is that Ofgem set the desired output-based funding that allows users' needs to be met but without prescribing how this will be delivered.

Review of DPCR5 mechanisms

SSEPD agree with Ofgem that some aspects of DPCR5 are working well and that it would be inefficient and unnecessary to revisit these for RIIO ED1. We also consider it important to achieve stability across price control periods where possible and in areas such as pensions, taxation, the IQI mechanism and incentivising outputs.

However, there is always room for improvement and it should be remembered that 2023 will not be like 2009 when the DPCR5 settlement was agreed. Behaviour that resulted in the mechanisms for DPCR5 is unlikely to be the same for the next price control period, and RIIO ED1 must be informed by the current views and expectations of our customers to ensure that this mechanism still works and is fit for purpose.

Smart meters

SSEPD is committed to playing its part in meeting the government's objective for the installation of smart meters across our networks. We note that Ofgem has stated it is working with the Department of Energy and Climate Change to ensure costs associated with smart meter installations are appropriately borne between competitive supplier mechanisms and DNOs. We support this approach and welcome further clarity on cost allocation and recovery without delay.

We also consider it important for Ofgem to clarify the regulatory framework for the roll-out of the smart metering programme across RIIO ED1. We are concerned that there currently appears to be no formal co-ordinated programme for roll-out and this has the potential to create a number of issues for DNOs. For instance, DNOs will need to plan ahead for resourcing the roll-out of smart metering over the short, medium and longer-term.

Given the significant numbers of smart meters to be installed, further clarification of the regulatory framework should be provided to DNOs as a matter of urgency. One possible solution could be to provide an ex-ante allowance for DNOs to appropriately cover the costs of the smart metering roll-out, with volume acting as an appropriate driver of such an allowance.

Improving cost assessment

SSEPD believes that Ofgem should continue to reward DNOs for operating at the frontier of efficiency.

We acknowledge that we have moved into a totex environment which we support. However, it is important that the monitoring of performance is undertaken on a consistent basis with how allowances and targets were set. An appraisal of the whole cost of an investment, including capex and opex, would overcome this issue.

SSEPD therefore considers it essential that future efficiency of DNOs should be assessed across all totex and DNOs should be rewarded for having the lowest unit costs. Ofgem should also develop transparent benchmarking analysis based upon outputs not inputs.

We note that Ofgem already requires DNOs to disclose a high level of detail with regard to their annual costs and performance in the delivery of outputs. Given the considerable time and cost associated with the collection of this data, we consider it will continue to be important for Ofgem to demonstrate, in a transparent way and for the benefit of customers, how this data will be used and applied in RIIO ED1.

Timetable and outputs

SSEPD generally agrees with the timetable proposed by Ofgem for RIIO ED1, but we note this will be extremely challenging for all concerned. The timeline proposed does not appear to allow for any unforeseen delays that may arise. Accordingly, we support the use of working groups to support Ofgem and are keen to progress on this basis.

We also note that DNOs will be required to complete detailed data templates as part of the RIIO ED1 process. We consider it essential that all templates should be made available to DNOs at the earliest opportunity. Our preference would be to see these templates and guidance released no later than the proposed publication of the strategy consultation in September 2012.

SSEPD is committed to working with Ofgem to deliver the required outputs against the timeline proposed, and ensure that efficiency is measured against these outputs. We generally agree that the outputs proposed appear to be fit for purpose. As noted previously, we would again emphasise that a redeeming feature of the RIIO approach will be to ensure that DNOs are sufficiently incentivised to deliver the outputs required by our customers.

We believe that Ofgem should consider incorporating a social obligation output that measures the contribution of DNO investment activities to local, regional and national community development. All DNOs will invest significantly over RIIO ED1 and this activity will have a major impact on our communities, with the potential to create many social and economic benefits. For these reasons, we consider it appropriate for Ofgem to ask DNOs to report on how they contribute to local and regional economies, how their business practices maximise the creation of wealth and new business opportunities for other organisations and the estimated number of jobs that have been created within the communities they serve.

We also consider that Ofgem should incentivise DNOs for good environmental performance and establish formal outputs and reward mechanisms that will encourage this behaviour.

Length of price control

SSEPD acknowledges that the length of the recent RIIO transmission price control review (RIIO T1) and the ongoing gas distribution price control review (RIIO GD1) have, or propose to set, regulatory periods of eight years. It therefore seems logical to us that the length of the RIIO ED1 price control period should be of similar length unless there are any clear reasons as to why this should not be the case and providing this offers more regulatory certainty.

An eight year price control period already presents significant challenges to DNOs, especially where the requirements and outcomes of smart grid developments remain unclear and are constantly changing. This will result in significant uncertainty for DNOs and a longer regulatory period is likely to exacerbate this situation further.

If Ofgem is considering extending the price control period beyond eight years, then it will be important to signal why this is appropriate and the material benefits that stakeholders can expect to receive as a direct result.

Rather than further extending RIIO ED1 to nine years, our preference would be for Ofgem to roll-over the current DPCR5 by twelve months and then commence the next price control period in 2016. In any event, Ofgem will need to be clear about the timing and scope of any mid-period review that will happen during RIIO ED1.

Business plans and proportionate treatment

SSEPD supports Ofgem's view that well justified business plans, setting out what will be delivered and how this will be achieved, must be informed by stakeholder engagement.

We also agree that it is extremely important for Ofgem to adopt a transparent approach to assessing DNO business plans and to fast-track where possible. We believe this reduces the regulatory burden on DNOs and Ofgem, and enables businesses to focus on delivering their business plans without the need to undergo further time consuming business plan preparation.

Furthermore, we believe that the fast-tracking of business plans leads to greater understanding for stakeholders and customers to better appreciate what DNOs will deliver, when this will happen and at what cost. We consider that RIIO ED1 presents an opportunity to reduce the complexity of setting price controls, particularly where business plans can be fast-tracked.

Following the receipt of T1 and GD1 business plans from the respective businesses, Ofgem has made it known that it found it difficult to compare business plans. We are happy to support any initiative that assists this process, but it will be critical for Ofgem to ensure there is transparency in setting-out early the level of disclosure it requires from DNOs and how this will be assessed. Equally, it would be useful for Ofgem to signal at the earliest opportunity how they believe DNOs can differentiate amongst themselves and how this will be assessed, as we consider that any attempt to standardise DNO business plans will not make them easier to compare.

Enhanced stakeholder engagement

We agree that stakeholder engagement is an integral part of our business and the RIIO ED1 process.

Engagement with our customers will be a core part of preparing our business plan, and we will look to work collaboratively with other DNOs in achieving this where possible.

It is important to understand that different types of engagement are favoured by different stakeholders. Our experience tells us that future engagement must be on our customers' terms and be focused on issues that are of specific concern and importance to them.

Concluding remarks

SSEPD is committed to working proactively with Ofgem to ensure that the RIIO-ED1 process achieves the right outcomes for our customers and appropriate incentives for DNOs to continue to meet the expectations of our stakeholders.

We are happy to discuss further any aspect of our above comments with you and look forward to working with Ofgem over the coming months on all aspects of the RIIO ED1 process.

Yours sincerely,



Aileen McLeod
Head of Regulation, Networks