

Mark Wagstaff,
Ofgem
9 Millbank
London
SW1P 3GE

11 June 2013

Dear Mark,

REVIEW OF OFGEM'S IMPACT ASSESSMENT GUIDANCE

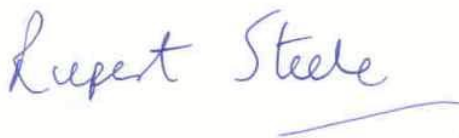
Thank you for the opportunity to respond to the consultation letter on Ofgem's revised Impact Assessment Guidance, dated 18 March 2013.

We are generally supportive of the revised guidance. An iterative approach to impact assessment, where impacts are considered throughout policy development, is helpful – but this should not be at the expense of systematically, clearly and formally setting out the costs and benefits of a proposed course of action at the appropriate point in the process.

Our responses to the specific questions raised in the consultation are in Annex 1 to this letter.

Should you wish to discuss any of the above points, please contact me via the details provided or contact Rhona Peat (rhona.peat@scottishpower.com).

Yours sincerely,



Rupert Steele
Director of Regulation

**REVIEW OF OFGEM'S IMPACT ASSESSMENT GUIDANCE – RESPONSE BY
SCOTTISH POWER**

Q1. We are proposing to revise the structure of the guidance to place greater emphasis on Impact Assessment (IA) as a continuous, iterative process. Do you agree with our approach / emphasis?

We are broadly supportive of Ofgem's proposal to place greater emphasis on IAs as a continuous, iterative process. However in the interests of a fair and robust process, we think that it is important to consider stakeholder views in the detailed application of IAs in particular cases. Accordingly, we believe that within this iterative process there needs to be early and continued engagement with impacted stakeholders, transparency of any assumptions made and factors assessed, including the need for all analytical techniques used within the analysis to be chosen and designed in a robust manner. The iterative approach should not however be at the expense of systematically, clearly and formally setting out the costs and benefits of a proposed course of action at the appropriate point in the process.

We would also welcome clarity on what basis Ofgem will stop the iterative process and move to the final assessment of their preferred option at Stage 4 of the IA process. In particular, we believe the guidance may be improved by further clarity on how the three different aspects within the iterative assessment at Stage 3 may be weighted in making a final decision. We cover this in more detail in our response to Question 2 below.

We particularly welcome the clear direction that in Stage 2 of the IA process Ofgem will develop a set of initial options that include a "do nothing" option, and that in Stage 3 this option can be used as a baseline to assess the other options against. We believe that all proposals should be compared against the relevant "do nothing" option to ensure that the full impacts, costs and benefits are considered within the impact assessment.

Q2. Our proposed approach to assessing impact, costs and benefits is to develop an iteration of options between three aspects. These are: monetised, aggregate cost-benefit analysis; distributional effects; and long-term, hard-to-monetise considerations. These assessments are informed by a consideration of our principal objective to protect consumers (existing and future) and our other statutory and EU duties, including considerations of competition (EU and domestic). Do you agree with our approach to assessing impacts? We welcome any views on this approach, and the specific content within each category.

We are broadly supportive of Ofgem's approach to assessing impact, costs and benefits across the three aspects: monetised, aggregate cost-benefit analysis; distributional effects; and long-term and hard to monetise considerations.

One area where we feel that more detailed guidance should be provided is the scope of the monetised, aggregate cost-benefit analysis; in particular, whether this aspect of the cost-benefit analysis should focus on:

- a) overall economic impact – ie the impact on firms as well as consumers ('producer surplus' plus 'consumer surplus'); or
- b) consumer impact – eg consumer prices or bill impacts ('consumer surplus' only).

Focusing on the overall economic impact ((a) above) would be consistent with Treasury Green Book guidance¹ and is the approach adopted in many Government impact assessments. It is also consistent with Ofgem's principal objective relating to current and future consumer interests, as in the longer term producer surplus will normally lead to one or more of market entry, more investment, and enhanced security of supply. Producer surplus is therefore likely to be competed away in time or lead to other benefits. An approach focussing on consumer surplus alone risks selecting options that are sub-optimal or not economically sustainable in the longer term.

We therefore think the default approach for the aggregate cost benefit assessment should be to focus on overall economic impact, unless there are good reasons to focus more narrowly (in which case those reasons should be explained). Any trade-off between producer and consumer surplus can then be considered under the heading of distributional effects, alongside any distributional effects between different categories of consumer. This lends itself well to the more systematic approach proposed in Ofgem's new guidance and would also be consistent with Green Book guidance on Regulatory Impact Assessments².

As noted in our response to Question 1 and previously in our response to Ofgem's letter "Strengthening Strategic and Sustainability Considerations in Ofgem Decision Making", it would be helpful for Ofgem to provide more clarity as to how the three different aspects of the assessment will be used in ranking alternative options. For example, will the aggregate CBA measure be used as the primary measure for ranking, with the two others used as 'tie-breakers'? Or will it be possible for distributional or long term sustainability issues to 'trump' the aggregate CBA measure in certain circumstances? The final assessment methodology is most likely to be fit for purpose if it is known in advance how it is to be used. It may also reduce the risk that decisions are held up by debate around the impact assessment.

Q3. We have interpreted our duty to have regard to sustainable development by considering a mid-term stress and security assessment and a long-term natural asset and greenhouse gas assessment. For more detail on this approach, please see our recent discussion paper "Strengthening strategic and sustainability considerations in Ofgem decision making" (June 2012). Do you agree with our approach to considering long-term, complex and hard-to-monetise issues? We welcome any views on this approach.

As we noted in our response to Ofgem's above noted discussion paper, in general we are supportive of Ofgem's approach.

We agree that monetisation of certain aspects of the assessment is likely to be extremely challenging (for example long term environmental and sustainability issues) and that dealing with these issues in a separate module of the assessment may improve overall transparency. However, great care will be needed to ensure that double counting is avoided, eg where environmental considerations are already factored into the CBA via environmental taxes/subsidies. We recognise Ofgem's aim to avoid double-counting in paragraph 3.40, but we think this is an area in which Ofgem's guidance could usefully be made more explicit.

¹ 'In principle, appraisals should take account of all benefits to the UK' (HMT Green Book, para 5.25)

² "Although the trigger for producing a RIA is that the proposal could affect businesses, charities or the voluntary sector, the RIA itself should cover the full range of economic, social and environmental effects, in line with the Green Book methodology.' (HMT Green Book, para 2.23)

The guidance includes reference to 'mid term' strategic effects and 'long run' sustainability effects. We think this terminology could be misleading as it suggests that environmental considerations such as climate change are confined to the long run sustainability heading. As we understand it, this is not the intention, and impacts on progress toward medium term Government sustainability or emissions targets are included in the analysis of mid term effects.

Q4. Are there any other substantive changes that we should consider incorporating in the guidance, as appropriate to our statutory duties and functions?

We would suggest that in assessing whether a proposal is "important" under Section 5A of the Utilities Act 2000 and therefore whether an impact assessment should be undertaken, proposals which are likely to result in a "significant impact" in the Table in paragraph 2.8 should also include proposals where the timescales for implementation of the proposal would result in a significant impact on industry participants.

In light of the changed emphasis within this guidance on the IA as a continuous, iterative process, it would also be helpful to understand how Ofgem's IA process and guidance aligns with IA guidance and processes used within Government and its departments and agencies. It remains important to prepare an analysis systematically, clearly and formally setting out the costs and benefits of a proposed course of action at the appropriate point in the process

ScottishPower
June 2013