

By e-mail

Joanna.campbell@ofgem.gov.uk

Joanna Campbell
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Your ref

Our Ref

Date

4th November 2013

Contact / Extension

Chris Elderfield

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Dear Joanna

RIIO-ED1 Consultation on the timing of a decision on electricity distribution networks' revenue for 2015-16

I am writing on behalf of SP Distribution Ltd and SP Manweb plc in response to the consultation issued on 4 October 2013. We welcome the opportunity to comment on the issues raised.

In summary we believe there is no merit in departing from the current RIIO-ED1 review process which results in revenue for all DNOs being finalised at Final Determination (FD) scheduled for November 2014. Any departure from established regulatory certainty, with the consequent cash flow volatility caused by recovery of deferred revenue, is likely to be unfavourably received by both consumers and credit rating agencies. The onus should be on suppliers to justify any departure from established practice with the emphasis on the benefit for consumers.

Therefore our preferred option is option (a). If either options (b) or (c) are determined, then option 3 for recovery of deferred revenue is our preference. The true up methodology for recovery of deferred revenue is likely to be complex. As a result we believe this should be well documented in advance and finalised before final proposals in November 2014 (including any associated Licence drafting). We wish to be consulted on the drafting.

Our detailed comments on the questions set out in the consultation appear in the attachment to this letter.

Ochil House, 10 Technology Avenue, Hamilton International Technology Park, Blantyre, G72 0HT

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**SP ENERGY
NETWORKS**

Regulation & Commercial

Please contact me if there are any queries.

Yours sincerely,

**Chris Elderfield
Regulation and Commercial
SP Energy Networks**

Att,

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RIIO-ED1 Consultation on the timing of a decision on electricity distribution networks' revenue for 2015-16 – consultation 4 October 2013
Comments by SP Energy Networks – November 2013

Questions

Question 1: Please provide any relevant information to improve our analysis of the benefit of each option including (if available):

- (i) Information on the risk premium included in contracts offered to consumers; and
- (ii) The expected reduction in the risk premium an additional 4 months (option (b)) and an additional 11 months (option (c)) would provide.

Please specify if you wish any data provided to remain confidential

We have seen no evidence that there is any benefit for customers or electricity distribution networks operators (DNOs) in making an earlier than proposed decision on the base revenue that will be recovered in 2015-16. Options (b) and (c) are likely to result in cash flow volatility caused by recovery of deferred revenue, and this is likely to be unfavourably received by both consumers and credit rating agencies. It should also be noted that companies' total allowed revenue in 2015/16 will also be impacted by performance against incentives during the DPR5 price control period and their overall price control recovery position at the end of 2014/15.

Question 2: Do you have any views on the potential costs we have identified? Do you consider there to be other costs we have not identified?.

We believe that the consultation captures the main costs. However, in the example where revenue is lower under option (b) or (c) than that which would have been decided under option (a) the consultation correctly identifies that DNOs would need to fund output delivery from sources other than through charges to consumers. The resultant additional funding risk for DNOs will lead to artificial volatility in financeability ratios creating adverse signals to financial markets (credit rating agencies would react to this) with a consequent upward impact on the cost of capital.

Question 3: What is your preferred treatment of deferred revenue? Please explain your reasoning.

We support option 3 (deferred revenue could be recovered in 2016-17 unless it breaches a specified threshold). We believe it is important to eliminate the volatility in financeability ratios as quickly as possible to avoid uncertainty in the financial markets.

Question 4: If you prefer option 3 for deferring revenue, what do you consider an appropriate threshold? Please explain your reasoning.

We believe that the threshold should be 1% of 2015-16 base revenue that would have been determined under option (a). We believe that the amount of deferred revenue could be significant for slow tracked companies, particularly if option (c) is chosen.

Question 5: Do you have any views on our initial assessment of each option?

We agree with your justification for concluding that option (c) for the base revenue decision date is an unattractive option. We believe that the additional funding risk for DNOs noted in our response to question 2 means that option (a) is the preferred solution and maintains established regulatory certainty.

Question 6: Which option do you consider will drive the greatest benefit to consumers? Please support this view with analysis of the costs and benefits.

The benefit for end consumers has to be weighed against the views of credit rating agencies. We believe that the regulatory certainty of option (a) which eliminates the volatility in charges caused by deferred revenues would be attractive to consumers.

Question 7: Do you have any views on the relative complexity of option (b) and (c)?

The true up methodology for recovery of deferred revenue is likely to be complex. As a result we believe this should be well documented in advance and finalized before final proposals in November 2014 (including any associated Licence drafting). We wish to be consulted on the drafting.