

**SP ENERGY NETWORKS (SPEN) ON BEHALF OF SP
DISTRIBUTION PLC, (SPD) SP MANWEB PLC, (SPM)
AND SP TRANSMISSION PLC (SPT)**

**Response to: RIIO-ED1 Business plan assessment
and fast-tracked consultation; and
RIIO-ED1 Draft Determinations for fast-tracked
Distribution Network Operators – Western Power
Distribution**

SP ENERGY NETWORKS (SPEN) ON BEHALF OF SP DISTRIBUTION PLC, (SPD) SP MANWEB PLC, (SPM) AND SP TRANSMISSION PLC (SPT)

**Response to: Assessment of RIIO-ED1 business plans and fast-tracking; and
RIIO-ED1: Draft Determination for Western Power Distribution Ltd.**

1. INTRODUCTION

- 1.1 This document provides the SPT, SPD and SPM, (SPEN)¹, response to (i) the RIIO-ED1 Business plan assessment and fast-tracked consultation; and (ii) the RIIO-ED1 Draft Determinations for fast-tracked Distribution Network Operators – Western Power Distribution².

2. RESPONSE TO OFGEM'S ASSESSMENT OF RIIO-ED1 BUSINESS PLANS AND FAST TRACKING

- 2.1 Ofgem published its assessment of the DNOs' business plans and draft determination on fast tracked DNOs on 22 November 2013, with further detail published on 6 December 2013. Subsequently, SPD and SPM have carried out a detailed review of Ofgem's assessment and draft determination.

SPEN's ongoing commitment to RIIO-ED1

- 2.2 At the outset, SPEN emphasises that it is committed to working with Ofgem throughout the remainder of the RIIO-ED1 process to ensure that it results in a high quality outcome which protects and benefits SPEN's stakeholders such as:
- 2.2.1 The consumers who rely on the SPEN distribution systems for a secure and reliable supply.
- 2.2.2 The general public and SPEN employees who properly require SPEN to conduct its operations to reasonable and prudent standards of safety.
- 2.3 We have no doubt that Ofgem has the same objective.
- 2.4 Whilst SPEN is very disappointed with the outcome of the assessment, we will continue to dedicate significant resource to ensure that the normal track process meets the above outcomes.
- 2.5 This response contains SPEN's observations which have given rise to serious concern in relation to Ofgem's approach to RIIO-ED1 to date. These are set out because SPEN wants to ensure that the remainder of the process results in a high quality outcome for all of SPEN's stakeholders. SPEN is in no doubt that Ofgem shares exactly the same objective. A robust and constructive dialogue between Ofgem and SPEN will go a long way to achieving this.
- 2.6 SPEN's experience of the RIIO process in the context of RIIO-T1 enhances SPEN's confidence that a high quality outcome can be achieved.
- 2.7 SPEN fully understands that the RIIO-ED1 process is highly demanding of the Ofgem team, in particular given the unavoidable complexity of the business plans and issues involved. SPEN is committed to working with Ofgem to ensure a high quality outcome in this context.
- 2.8 In these circumstances we are confident that Ofgem will treat the following comments as the basis for constructive dialogue and the starting point for further work designed to secure a high quality outcome for consumers.

¹ SP Energy Networks (SPEN) is the trading name of SP Distribution plc (SPD), SP Manweb plc (SPM), and SP Transmission plc.

² Please note that this document does not contain any references to Equity Market Returns as we responded to the separate Ofgem consultation in this regard. Copy attached as Appendix for ease of reference.

The SPEN Business Plan

- 2.9 SPEN's Business Plan has been developed over a two year period to reflect the priorities of its stakeholders and customers, such as additional storm resilience, whilst also targeting increased investment to manage the threat to security of supply and public and staff safety presented by end-of-life network assets. The plan has also been designed to deliver cost savings for customers, for example embedding more than £100m of innovation savings to meet the challenges of the next decade.

The objective of SPEN's review of Ofgem's assessment

- 2.10 The SPEN review of Ofgem's assessment has been carried out with a particular emphasis on high quality stakeholder outcomes. SPD and SPM want to ensure that the RIIO-ED1 process secures a high quality outcome for consumers, as an example by ensuring that SPD and SPM can continue to provide a secure and reliable supply. Consumers, the general public and SPEN employees are also entitled to a safe network. SPD and SPM submitted a Business Plan to Ofgem which focussed on delivering a range of important objectives at good value for money, designed to ensure these outcomes including:
- 2.10.1 Managing SPEN's ageing network to maintain public staff and contractor safety;
 - 2.10.2 Investing to reduce the risk of power cuts during major storms; and
 - 2.10.3 Improving service to poorly served customers.
- 2.11 SPEN's conclusion is that if Ofgem was to apply the same assessment criteria for the normal track process it would not provide enough funding to enable SPEN to achieve these important objectives, which we can show flow from legitimate stakeholder requirements.
- 2.12 Further, the Ofgem approach would mean that SPM and SPD's ability to comply with their mandatory legal requirements would be seriously compromised.

Engagement since the publication of the assessment

- 2.13 SPEN has difficulty in understanding material aspects of Ofgem's assessment. SPEN has invited Ofgem to help it to understand these areas. Whilst SPEN is grateful that Ofgem has confirmed an industry meeting on 17th January 2014, it would have been better if this meeting had taken place earlier and bilateral meetings were arranged prior to the submission deadline date.

Lack of engagement during the assessment

- 2.14 SPEN understood that the process would change from RIIO-T1 to RIIO-ED1, mainly in relation to the ability to resubmit. However, SPEN did not anticipate that there would be an almost complete lack of meaningful technical engagement between Ofgem and SPEN, during the critical assessment period.
- 2.15 Although there is a great deal of commonality between each of the DNOs, there are also significant differences. This means that plans must be assessed on an individual basis. However, SPEN's perception is that Ofgem did not properly take into account the specific individual circumstances applicable to SPD and SPM, and therefore by extension, their consumers and other stakeholders.
- 2.16 Ofgem did not engage with SPEN on its specific Business Plan. As an example, there were very few questions which specifically related to SPD and SPM. Rather, the vast majority of questions appeared to be generic to all DNOs, the inference being that in the main all DNOs were provided with the same questions. This is to be contrasted with Ofgem's process for RIIO-T1, during which SPEN received over 1000 bespoke questions.
- 2.17 Further, SPEN is concerned at the lack of apparent engineering input into the assessment given that it depends on a thorough appreciation of the engineering aspects of the Business Plan. Unlike under RIIO-T1, there was negligible bilateral dialogue between SPEN and Ofgem about the engineering aspects of the plan. Ofgem did make it clear that the process would be

different to RIIO-T1, however this was particularly in relation to opportunities to resubmit plans. SPEN did not take this to mean that there would be very little meaningful engagement with SPD and SPM. As a diligent DNO, we sought to listen to the public statement made by Ofgem, which emphasised that RIIO-ED1 would not be a new departure from previous RIIO price controls. As a RIIO-T1 company, we are in a position to confirm that there has in fact been a substantial shift from previous RIIO reviews' approach and we believe this is true in comparison with RIIO-GD1.

Lack of transparency as to relevant criteria

- 2.18 The criteria by which business plans are assessed should be transparent and the subject of consultation. Ofgem have applied material new criteria and methods of evaluation in the assessment with no consultation or discussion before the assessment was published.

Ofgem's substantive assessment

- 2.19 Ofgem's unit cost analysis recognises that SPEN's investment unit costs are efficient, with the exception of some assets where the Manweb network design requires different specifications, and 132kV investments where individual project assessment is more appropriate.
- 2.20 Ofgem's volume assessment concludes that SPEN are planning to invest at much higher volumes than is efficient, however this and other components of Ofgem's assessment have a number of material misunderstandings. We recognise that this may occur in complex projects of this nature and we will engage with Ofgem to assist in clarifying Ofgem's misunderstandings and continue to urge Ofgem to give us sufficient opportunity to do so.
- 2.21 One such misunderstanding relates to innovation, which is one of the "pillars" of RIIO-ED1. The assessment penalises SPD and SPM for embedding innovation in their mainstream business and investment activities, for example in the context of the deployment of phase shift transformers.
- 2.22 Ofgem's approach appears to classify a range of essential expenditure as inefficient or otherwise superfluous. A proper analysis of SPD and SPM's individual circumstances would show this not to be the case. As an example, £238m of expenditure is deemed inefficient as a result of median or average benchmarking. However, the expenditure is essential because of SPD and SPM's position in their individual investment cycle. All DNOs have different investment cycles, arising as a result of investment decisions made over the last fifty years. In the case of SPD and SPM, increasing numbers of assets are reaching the end of their useful lives. The application of sound engineering analysis demonstrates this to be the case.
- 2.23 Many weaknesses in Ofgem's assessment, as perceived by SPEN, appear to flow from the lack of expert engineering dialogue and analysis, and the more general lack of dialogue with Ofgem about SPD and SPM's individual circumstances.
- 2.24 Ofgem has relied heavily on top down models and not the engineering operational facts and investment needs of the individual DNOs which lie behind them. Models used in isolation are not capable of showing the full picture.

Moving forward

- 2.25 Whilst SPEN is very disappointed with Ofgem's assessment of the SPD and SPM business case, SPEN will continue to dedicate significant resource to RIIO-ED1 and the SPEN team fully understands the need to work with Ofgem in a productive and collaborative way.
- 2.26 SPEN recognises that some of Ofgem's criticisms of the SPD and SPM Business Plan have a basis, for example, in relation to ongoing improvements to historic asset data. However, SPEN sought to address these criticisms during the process, and with greater dialogue outstanding issues could have been resolved. SPEN is therefore committed to working with Ofgem to address these criticisms.

- 2.27 SPEN is committed to working with the RIIO-ED1 team to protect the interests of our customers through the normal track process and continues to review the detail of the Ofgem assessment to identify areas where its plans can be improved or refined, for example:
- 2.27.1 providing more detail on the costs associated with the unique Manweb network design and the different distribution voltage levels in Scotland to those in England and Wales (132kV);
 - 2.27.2 providing more detail on the differences arising from more challenging low carbon targets in Scotland and Wales; and
 - 2.27.3 sharing the detailed engineering evidence that supports SPEN's investment plans.
- 2.28 SPEN looks forward to continuing to work with its stakeholders and Ofgem on the important issues engaged by the RIIO-ED1 process. We understand it is not just providing and sharing of information that Ofgem may require but also explanation and justification of that information, which allows Ofgem to fulfil its monitoring and assessing duties. We intend to provide comprehensive justification and explanation not only in our written submissions but also when we meet with GEMA.

3. RESPONSE TO DRAFT DETERMINATION FOR WESTERN POWER DISTRIBUTION (WPD)

- 3.1 Naturally SPD and SPM's focus has not been on the proposed determination for WPD. The focus has been on the Ofgem assessment of the SPD and SPM Business Plan, and the consequences for SPEN, and its stakeholders (including customers, investors, employees) of that assessment. This is naturally SPEN's first priority. SPEN must also consider the assessment in detail in preparing its resubmission. It was also essential to prepare the response to the simultaneous equity market return consultation.
- 3.2 Under these circumstances, SPEN has not been able to consider the draft determination about WPD in the fullest detail. However, SPEN would make the following observations in respect of WPD:
- 3.2.1 It has been allowed transition despite having strong credit statistics without it. Ofgem's view is that transition is a timing issue and is value neutral for customers in the long term. For WPD customers this will increase customer bills throughout the period 2015 to 2023 with the biggest impact in 2015-16.
 - 3.2.2 WPD's plans include a real price effects allowance of 8% of totex.
 - 3.2.3 WPD was ranked last of all DNOs on its innovation strategy, failing five out of eight assessment criteria. However, innovation is one of the three "pillars" of RIIO. As such SPEN is now quite unclear as to the weight innovation bears in the context of the RIIO-ED1 assessment, and the extent to which innovation has been properly considered across the price control assessment. This suggests a lack of clarity with regard to your weightings on innovation and we look forward to hearing Ofgem's views on its approach to weighting so that we can take this approach into account in our resubmissions.
 - 3.2.4 WPD's plans include a relatively low load trigger (90% loading) for major substations, which is materially lower than the trigger applied by other DNOs in seeking to balance network risk and cost to customers. As a consequence, WPD customer bills will be higher than if they had accepted a level of risk similar to the other DNOs.
 - 3.2.5 A Cost Assessment Credit was provided to WPD for accepting tighter CI/CML targets than Ofgem proposed, even though it appears these improvements will be delivered through customer-funded investments. No credits appear to have been given by Ofgem for other DNO commitments valued by customers, for example load investment triggers.
 - 3.2.6 SPEN notes that WPD's proposed £54m ESQCR spend associated with low ground clearances only across roads has been considered efficient, although SPEN notes that WPD categorises these as 'Legal and Safety' rather than ESQCR costs unlike other DNOs.

- 3.2.7 A new cost driver of Weighted Modern Equivalent Asset Value (Weighted MEAV) to benchmark a number of cost categories based on actual spend in 10/11 and 12/13 was introduced. This serves to increase the apparent efficiency of DNOs who have higher than average investment in underground cables, resulting from a combination of higher fault repair costs and/or a proactive cable replacement programme. Based on the available information, SPEN believes this would include WPD.
- 3.3 The impact, (direct or indirect) of the proposed WPD determination on the assessment of the SPD/SPM resubmission is something that Ofgem must clarify as soon as possible. As an example, the extent to which it sets a precedent for the normal track requires clarification. We look forward to resubmitting our plans in the knowledge that Ofgem's preferences and approaches have been properly understood and taken into account.
- 3.4 SPEN has raised a number of concerns about the way in which Ofgem has approached the assessment of the SPD and SPM Business Plan, both from a process and substance point of view. These concerns are well founded.
- 3.5 We are confident that Ofgem and GEMA will carefully consider whether the assessment of WPD's plans is sufficiently robust in advance of the final determination.

SP Energy Networks

SP Distribution plc

SP Manweb plc

SP Transmission plc

22 January 2014

APPENDIX

SP Energy Networks response to Ofgem Consultation on methodology for assessing the equity market return for the purpose of setting RIIO price controls