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Dear Hannah

Assessment of RIIO-ED1 business plans and fast-tracking

Scottish and Southern Energy Power Distribution (SSEPD) welcomes the opportunity to respond to Ofgem's assessment of the RIIO-ED1 business plans and draft determination for Western Power Distribution (WPD) licensees.

SSEPD has long been supportive of the RIIO price control model and, in particular, the onus on licensees to demonstrate through enhanced engagement with their customers that their business plans represent best value in forecast costs, outputs and service delivery. We welcome Ofgem's conclusion that the electricity distribution business plans are significant step forward from previous price controls and that all business plans have areas of strength. Further, we welcome the method by which Ofgem appear to have assessed all of the business plans holistically and have focused on the value for money of proposed outputs, rather than accepting a least-cost option. We look forward to this focus on evidence-based value for money for consumers continuing throughout the RIIO-ED1 process.

We recognise that Ofgem had a relatively short timeframe to assess the comprehensive plans submitted by DNOs last July and, hence, the detail published about that assessment is fairly limited at this stage. This lack of detail has meant that we have been unable to complete a full review of Ofgem's assessment, particularly in areas where consultants have provided support to Ofgem, such as IT, asset replacement and smart solutions. We believe it is essential that further information, including consultants' reports, should be made available to licensees prior the re-submission of business plans due on 17 March. Moreso, that Ofgem should maintain an 'open door' policy and work closely with licensees to ensure there is a thorough understanding of the basis of the initial assessment and thus achieve the best possible outcome for customers from the re-submitted business plans.

While SSEPD broadly understands the outcome of the assessment, we have two material considerations for which we believe require further detail of Ofgem's analysis:

- Next steps in the process of development and application of the cost assessment methodology.
- Implications of policy variance between the fast-track decision and the March 2013 strategy decision, and the requirement for variances to WPD's business plan to be made.

On the basis of these considerations, we are not able to support the decision to fast-track the WPD licensees. These issues are considered in more detail below.

We are also extremely concerned by the decision, at this late stage in the regulatory process, to reconsider the methodology for assessing equity market returns. This significantly, and in our view unjustifiably, increases regulatory risk and undermines the basis on which business plans were submitted. We have responded under separate cover to that consultation, and this response should be read in conjunction.

Cost assessment methodology

The development of the cost assessment methodology during 2013 had limited involvement with the licensees. This was disappointing, and it is our strong view that – now the initial assessment has been completed – there is no argument for such an arms-length approach as the methodology is further developed during 2014. It is our presumption that there will be no material change in the form, function or analytical process going forwards.

From the information provided, we have been able to understand the cost assessment methodology which appears to follow the combined top-down/bottom-up assessment set out in the March strategy decision. However, we have a number of questions about the process for the further development of the methodology as follows:

- We welcome the approach to normalisation adjustments that have been made during the cost assessment process, but note that this is an area where small adjustments might arise based on further information that is provided in the March re-submission. Early discussions on this would be welcome to ensure that appropriate information is provided to allow for these modelling adjustments to be made.
- The parameters for the IQI matrix have yet to be set. Confirmation on the timetable, process and range of this would be welcome. In addition, the contribution of the fast-track licensees to the setting of the IQI matrix.
- We have discovered a number of errors which have remained throughout the assessment process. Some of these errors are immaterial, however a number are fairly significant. We look forward to confirmation that these will be addressed.

Finally, we note that Ofgem has not set out how the weighting between the top-down and bottom-up methodologies was determined. Further, whether sensitivities on different weighting were undertaken and how this has been taken into account in the decision-making process (for fast-track and slow-track).

We also have some specific concerns about the application of Ofgem's cost assessment methodology in respect of the north of Scotland – as with previous price control review. We urgently require a specific meeting with Ofgem on these issues during the next few weeks, prior to resubmission of our business plan.

Draft determinations and March 2013 strategy decision

Whilst we support the principle of fast-track in RIIO price controls, we consider that there is insufficient information available for us to be able to conduct a full review of the WPD decision. Given the importance of the fast-track decision and the value of the financial (IQI) bonus awarded to WPD as a result of the fast-track decision, it is critical that the process of decision making and the reasons for the decision itself are fully transparent. In light of the concerns that Ofgem noted in its assessment of WPD's business plan, there are three particular areas where we would welcome further clarity:

- From the information available it appears that, although Ofgem scored WPD's business plan "green" in all areas, in their detailed assessment Ofgem has highlighted a number of concerns which have a direct and negative impact on the value for money and efficiency of WPD's proposals. We believe that Ofgem should provide explanation of how these issues have been taken into account in reaching the draft determination.
- WPD's business plan has been fast-tracked as submitted on the basis that it is of sufficiently high quality and good value for money for consumers. However, there are a number of areas in Ofgem's assessment where they consider that WPD's proposals are not fully justified and further information or revisions have been requested. If Ofgem are awaiting further justification from WPD post fast-track decision, we would welcome clarity on the process that Ofgem plan to use to ensure that this justification is provided and is sufficient, and how this impacts on the final settlement.
- We are surprised that Ofgem has selected all four WPD licensees for fast-tracking given that not all four are at the forefront of efficiency. We would welcome further information on why Ofgem have made that decision rather than simply fast-track the most efficient of the group, which the fast-track process clearly allows for.

Ofgem have strongly incentivised DNOs to provide their best possible business plan by offering the fast-track option and associated IQI reward. They have stated that a DNO could be fast-tracked providing that its business plan is of sufficiently high quality and good value. However, there is no imperative to fast-track any DNO and it is not expected that the "best" DNO would be fast-tracked if there were still concerns about the

quality and value of its business plan. In light of the concerns raised in the assessment of WPD's business plan, it is critical that Ofgem provide further information on how and why they have concluded that WPD's plans are suitable for fast-tracking and how variances from the March strategy decision were considered.

Please do not hesitate to get in touch if you wish to discuss this response further.

Yours sincerely,

Aileen McLeod

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