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Dear Chris,

Consultation on close out methodologies for the DPCR5 Price Control

We support the opportunity to input into this process and the collaborative approach shown to date through frequent working groups and Ofgem engagement. Many of the methodologies under consideration, for example, close out of DPCR5 Network Output Measures, align or show strong parallels with mechanisms carried into RIIO-ED1. It is therefore appropriate to give this due consideration to guard against unhelpful precedents being set.

There are several common themes in our response, namely around Ofgem's expectations in terms of any cost benefit analysis work carried out in DPCR5 and the need to ensure that any judgements being made over DPCR5 decisions for the purposes of close out are made based upon information that could reasonably have been expected to be available at the time. We are keen to remain fully engaged in the process and would ask that, as far as possible, where further input or information requests are required, Ofgem gives us the earliest possible sight of these requests.

The attached is a high level response to what is the first step in the process leading to changes in both our licence (CRC 3A) and the Financial Handbook (Part 3) at the end of March 2016. Ahead of this, we understand that Ofgem will publish its close out report at the end of this year. Whilst separate to this consultation, we would welcome further clarity from Ofgem in terms of the proposed process between now and the end of the year and then for the period January to March 2016.

Should you wish to discuss any of the above, please do not hesitate to get in touch.

Yours sincerely,

Gillian Hilton
Regulation, Networks

CHAPTER: Two

1. Do you agree with the principles for the NOMs assessment?

We are generally supportive of the principles outlined in paragraph 2.14.

- It is a long established principle of price controls that network operators should retain genuine efficiencies, but not be rewarded for outputs or benefits that are not delivered.
- We agree that the 'overall level of network risk' is the correct reference point in deciding whether an adjustment is required or not. Assessment at an overall level and adjustment only where there is significant / material divergence also seems appropriate and consistent with mechanisms elsewhere in the price control.
- We support the principle of recognising innovative approaches to asset management over the period and not penalising DNOs 'for doing the right thing in the interests of customers'.

One area where we would express caution is in relation to the use of Cost Benefit Analysis (CBA) tools. This is an area that has moved on significantly in recent years and any reliance on these tools must take into account the information and models that were available at the time rather than being influenced by the information and models that are in place going into ED1. This aspect is clearer in some elements of the consultation than it is in others.

2. Do you agree with our approach to assessing performance on Health Indices?

The proposed methodology appears to be relatively pragmatic and, at a high level, the three stages set out in Appendix 2 appear sensible. However, there are a number of specific areas that we believe warrant greater clarity:

- (i) It is not clear to us the timing of the performance assessment submission, nor how the qualitative and quantitative assessments interrelate or which takes precedent, if any. The methodology should consider offering further detail on this to avoid uncertainty at a later date.
- (ii) We believe Ofgem should provide greater clarity on its expectations with regards to any CBA that may be required. As mentioned in our response to Question 1, it would not be appropriate to expect DNOs to produce CBA models akin to those in ED1 given that this is an area that has evolved considerably and may well not have been available / in use at the time when DPCR5 decisions were made.
- (iii) Whilst we recognise that this methodology is still in its infancy, we believe Ofgem should provide greater clarity around its proposed sensitivity analysis. For example, it is not clear how consideration of alternative HI band weightings (which are very subjective) improves the robustness of the methodology.

Finally, whilst the methodology looks across the given voltage levels for the asset categories, we support the overarching principle that companies' success against the NOMs' deliverables should be at an overall level in order to ensure that companies are not penalised for any trade-offs that are to the benefit of the customer.

3. Which of the two approaches to valuing the Health Indices outputs gap do you consider to be more appropriate?

In valuing the outputs gap under Option 1, it is not immediately clear why Ofgem would divide the risk points' gap by its DPCR5 survey unit costs in order to obtain a volume of work and then multiply by a different unit cost.

Separately, the effective assumption in A2.17a), 'that the work delivering the HI movements is asset replacement', is flawed. This has been reflected in the RIIO working groups and the reporting packs, which recognise refurbishment secondary deliverable indices (SDIs) and non-SDIs. We would at least need to be comfortable that this element of HI movement is reflected in any valuation mechanism.

Notwithstanding this, at this early stage in the process and without further understanding of Option 1, we believe the most appropriate approach would be Option 2 given that, in broad terms, this is the metric for HI movement that DNOs have been working towards in DPCR5.

4. Do you agree with our approach to assessing performance on Load Indices and valuing any associated outputs gap?

The LI Networks Output workbook commits to delivering an improvement in LIs based upon the number of LI4s and LI5s remaining at the end of the DPCR5 period. As a general principle, we do not believe that the development of the points methodology for measuring 'load at risk' should be applied retrospectively to measure performance during DPCR5.

However, given that this is the methodology applied to ED1, we have the following comments on the points methodology set out in the consultation:

- A2.25. We would welcome further clarification of the meaning of 'to derive voltage level totals'. The LI workbook is split by Substation Reinforcement and Circuit Reinforcement, the points associated with these are totalled, but there is no further voltage split.
- A2.28. The proposed sensitivity analysis adds another element of uncertainty to how DNOs are going to be measured on risk points. It is not clear to us what the outcome of this sensitivity analysis would add to the process without further retrospective changes to the performance measure.
- A2.33. In valuing the outputs gap, we would like to ensure that 'primary reinforcement allowances' relate only to the (n-1) substation category and not to circuits.

More generally we would welcome recognition of improving security of supply at single transformer sites in SSEH, which have no back-feed and rely on mobile generation to provide capacity. There is currently no mechanism in this assessment of LI performance that is able to measure this.

5. Do you agree with our approach to assessing fault rate performance?

At a high level, the proposed approach appears reasonable and we welcome the scope for individual DNO justification / assurances where there is reason to suspect under-delivery.

6. Do you agree with our proposal not to make any financial adjustments associated with fault rate performance?

We believe this is appropriate given the lack of a direct and quantifiable link to expenditure.

7. Do you agree with the changes we have made to the assessment approach from DPCR5 FPs and the NADPR RIGs?

As this early stage in the process, the changes set out in Table 2.1 appear sensible, but will need more detailed development in a few areas before final sign on. For example, while a quantitative assessment of NOMs rather than just a qualitative assessment is positive given the work undertaken in this area during DPCR5, we still do not have final, agreed methodologies in all areas to be in full agreement, i.e. HI methodologies.

CHAPTER: Three

1. Do you agree with the principles for the load-related reopener assessment?

Please see our response to question 1 of Chapter 2.

In addition, whilst we generally support the use of comparative analysis, its value is more limited in relation to lower volume projects. The principles listed in para. 3.15 recognise this, but then reference that other tools and techniques, not necessarily developed at DPCR5 and ED1, may be used to assess the efficiency of expenditure. We do not believe it is appropriate to assess expenditure using tools and techniques that were not developed at the time. This is recognised elsewhere in the consultation and suggests that DNOs may be penalised as a result of the benefit of hindsight.

2. Do you agree with our approach to assessing expenditure on low volume high cost (LVHC) connections?

Whilst recognising comparative analysis as the driver, there will undoubtedly be an element of frustration for DNOs that do not trigger the reopener having to provide a performance assessment submission. This adds to an already heavy workload. Moreover, it is not clear how much benefit can be obtained from comparative analysis and benchmarking of low volume connection activities.

Notwithstanding this, we support the proposal that the level of information expected from the DNOs should be proportionate to the DNO's exposure under the reopener. This is a pragmatic middle-ground and we would encourage this to be reflected across all methodologies.

In para. 3.19 (and again in Appendix 3), we would encourage the removal of 'audit trails' in reference to supporting information. We understand the expectation that the evidence provided is robust, assured and commensurate with the information provided during the price control. However, it may not have been directly subject to internal or external audit in the same way as specific areas of our price control are, for example Regulatory Accounts.

3. Do you agree with our approach to assessing expenditure on general reinforcement?

In any of these 'ex post' assessments, it is key that Ofgem reviews the decisions made in DPCR5 against the information that was available at the time and upon which these decisions were made. The benefit of hindsight must not influence Ofgem's assessment.

4. Do you agree with our approach to assessing avoided reinforcement?

We support the onus being placed on the DNOs to provide the justification for costs avoided. However, we would encourage Ofgem to issue more general guidance on its expectations in this area. Experience from the ED1 price control, and conclusions from the subsequent CMA appeal, suggest that the quality of the process and subsequent decision is improved where definitions and guidance is provided in advance of network submissions. This is particularly important in the area of recognised innovation.

We would also reiterate the same comment as made in response to question 2 above in relation to the weighting given to audit trails in assessing a DNO's submission. We believe this needs to be realistic in terms of what can be expected retrospectively.

5. For non-DNO interested parties, do you have any evidence you can provide that would support our assessment of the load-related reopener?

N/A

CHAPTER: Four

1. Do you agree with the principles and general approach set out in this chapter?

Please see our response to question 1 of Chapter 2.

Separately, in Table 4.2, it recognises that Final Proposals did not consider that, at the end of the price control period, projects may not be fully completed. By their very nature, most of the outputs

of a price control must not be binary: it is possible to deliver some, all or more than the capacity requirements identified at Final Proposals. In which case, it would seem right that most project outputs should be considered on an incremental rather than absolute basis. We believe this is an important principle that should be considered across other mechanisms.

2. Do you agree with the changes we have made to the assessment approach from DPCR5 FPs?

At this early stage in the process, the changes set out in Table 4.2 appear sensible.

3. Do you have any suggestions on how we can assess outputs under the individual project categories set out in this document?

We believe this is an area that requires further work during the next round of working groups. Whilst the assessment looks to capture the 'gap' in spend caused by: (i) projects that have not gone ahead; (ii) projects that have failed to deliver or under-delivered on their outputs; and (iii) efficiencies, it does not appear to recognise where changes between baseline expenditure and actual expenditure are consistent with the DNO doing the right thing. For example, it does not appear to recognise if a project need has changed and the outputs are no longer required.

4. For non-DNO interested parties, do you have any evidence that would help with our assessment of HVPs?

N/A

CHAPTER: Five

1. Do you agree with our proposed methodology for adjusting DNOs' allowances to account for permitting costs?

Again, at a high level, the proposed methodology appears appropriate. In the consultation, Ofgem references the parallels with the Gas Distribution price control and the scope for benchmarking and comparative analysis. More than this, we would encourage Ofgem to reflect the learning from the Gas Distribution Network applications made to date.

While there is unlikely to be an application from SSEH under the TMA mechanism, we would encourage Ofgem to recognise that the terms used - 'TMA' and 'permits' - do not apply in Scotland. This has been noted by Ofgem elsewhere, but not in this current consultation.

Finally, we believe permit costs should be clarified to ensure that they clearly consider the wider cost and operational efficiency implications of complying with the permit scheme.

- 2. For wider stakeholders non-DNO interested parties – Do you have any information or evidence which would assist us in carrying out the TMA reopener assessment?**

N/A

- 3. Do you agree with our proposal to settle the TMA reopener mechanism early as part of the 2016 annual iteration?**

We support the general will from Ofgem to close out DPCR5 as early as possible to manage the workload of DPCR5 with the workload of ED1.