SCOTTISHPOWER

By email to:

switchingprogramme@ofgem.gov.uk

12 January 2017

Dear Natasha,

Draft direction on margin and incentives for DCC's role within the Transitional Phase of the Switching Programme

Thank you for the opportunity to respond to this consultation.

Our responses to the consultation questions are set out in the annex; however, we broadly agree with Ofgem's assessment of the requirements of the margin and incentive regime, and with its proposed application of it.

Should you wish to discuss any aspect of this response please do not hesitate to contact me or Colin Blair (colin.blair2@scottishpower.com).

Yours sincerely,

D McLaren

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Annex

CHAPTER: Three

Question 1: Do you agree with the proposed methodology for assessing DCC's margin, including the proposal to use EBT or net profit as the comparable measure? If not, please justify an alternative methodology.

Yes, we agree that a return on sales approach would offer a far more appropriate measure than, for example, EBITDA during the Transition phase; particularly given the asset light nature of the DCC's activities.

Question 2: Do you agree with our proposed assessment of DCC's risk? If there are further aspects to this which you feel have not been covered, please specify.

Yes, we agree with Ofgem's assessment that the programme, economic and reputational risks the DCC is likely to face during the Transition phase will be minimal, and that these already low risks are further mitigated by the ex-Post price control arrangements. With regard to regulatory risk, while Ofgem is probably best placed to assess the likelihood of manifestation, the nature of such risk is common to all licensees and, as such, is one the DCC should already have accounted for.

Question 3: What further comparators would you suggest we use in establishing DCC's margin? Please justify any proposed comparators and the suitability of using their corresponding industry.

We offer no further suggestions as we think the list of potential comparators offered in the consultation document is already fairly comprehensive.

CHAPTER: Five

Question 1: Do you agree with our minded to position for the shape of the margin at risk curve? Does it adequately address the desire to ensure DCC is motivated to deliver on time or as soon as possible thereafter? If not, please explain why and how it can be improved.

Yes, we agree that a two-point, straight-line, approach represents a fair incentive that maintains pressure on delivery, with the added benefit of being relatively simple, transparent and easy to administer.

The straight-line approach also has the advantage of not allowing the incentive to plateau during a period of delay. While there may be rationale for offering a window beyond each DM, during which less of the margin is placed at risk, we believe such windows might ultimately serve to undermine the intent and efficacy of the milestone regime.

Question 2: What is your view on our proposed position to determine the appropriate length of time after which 0% of margin is granted for each milestone? (What is the "X" in "T1+X"?) Please provide justification for any alternative suggestions.

In our view, the key to successful programme delivery lies in careful planning based on well informed assumptions. As such, we think the upper end of the proposed range of 15% - 25% of the time period allowed for each work package seems a little generous, particularly in light of the relatively low risk profile mentioned above. Therefore, we would prefer that the value of X reflect no more than 15% of the time period allowed for such activities, covered by the relevant DM, in the plan.

Question 3: Is 100% of the previously lost margin appropriate for the recovery mechanism where the final milestone is met on time? If not, what proportion would be?

We agree that allowing recovery of 100% of lost margin will ensure the strongest focus on delivering DM3 and maintaining progress along the critical path.

Question 4: Do you have a preference for the mechanics of the recovery mechanism (table 9) and whether recovery should be based on absolute or relative delay? Please support any suggestions.

We believe the recovery should be based on relative delay. This is because we believe such an approach will help to maintain the integrity of the incentive regime by ensuring that the percentage of lost margin that can be recovered at DM3, against either DM1 or DM2, is itself dependent on the relative improvement in the delivery of DM3.

ScottishPower
January 2017