Scottish & Southern Electricity Networks

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Dear Paul

This response is on behalf of Scottish Hydro Electric Power Distribution Plc (SHEPD) and Southern Electric Power Distribution Plc (SEPD) collectively referred to as SSEN in this response. SSEN welcomes the opportunity to comment on Ofgem's consultation on the Network Output Measures (NOMs) Incentive Methodology published on 26 March 2018. We have actively engaged with Ofgem and the other network companies via the NOMs Cross Sector Working Group (NCSWG) to help Ofgem develop the incentive methodology which is also consistent with Standard Licence Condition (SLC) 51 and CRC 5D.

We are generally supportive of the specific detail contained within the draft NOMs incentive methodology. However, we have highlighted where we have concerns and issues with the methodology in our responses to the seven specific questions outlined in appendix 1.

Yours sincerely

Kenny McAllister
Networks Regulation

Appendix 1 – NOMs Incentive Methodology specific questions

Question 1: Does the process as described in the draft methodology flow-chart represent a suitable means of implementing the data gathering and assessment phases of the incentive mechanism? Are there any improvements that you could suggest? Please state your rationale alongside any answers provided.

Broadly speaking we support the draft methodology flow-chart and believe this is representative of the process produced as a result of the NOMs Cross Sector Working Group (NCSWG). However, we have outlined our concerns on particular parts of the methodology in our responses to the specific questions below.

We would encourage Ofgem to engage and feedback the progress being made by network companies on their NOMs targets on an annual basis in more detail, potentially through an annual assessment following the submission of the RRP or as part of Ofgem's annual cost visit. This would be helpful to companies to ensure clarity of progress towards targets and will minimise any unexpected issues in the latter years of the price control period and the subsequent close out process.

Question 2: Do you agree with the use of a materiality threshold around the NOMs network monetised risk target to assess compliance? Do you consider that the range proposed for the Distribution sectors is appropriate? Please state your rationale alongside any answers provided.

We agree with the materiality threshold, or deadband as it is commonly known, in principle and that the 5% range being proposed for the Distribution sector is appropriate.

Every sector has either been through a rebasing exercise so far in their RIIO-1 Price Control or will be going through a rebasing exercise following the finalisation of the Common Network Output Measures Methodology, which will then allow for an appropriate level of materiality threshold to be set across all sectors.

Question 3: Do you agree that the exposure to the NOMs incentive should be measured from the upper/lower materiality thresholds? Please state your rationale alongside any answers provided.

SSEN agree that the exposure to the NOMs incentive should be measured from the upper/lower materiality thresholds.

This allows for the fact that prudent investment decisions may be made around the edges of a delivery target to the benefit of customers, and we feel that companies should be able to make these decisions without risk of penalty for lower delivery within the materiality threshold, while protecting customers from higher delivery within the materiality threshold.

Question 4: Do you agree with our proposal for how the associated costs of over/underdelivery are derived? Please state your rationale alongside any answers provided.

SSEN disagrees with Ofgem's proposal for how the associated costs of over/under-delivery are derived. We have significant concerns regarding Ofgem's proposal to retrospectively assess the efficient costs of schemes at the end of the price control which were delivered during the price control period.

We believe that any assessment should be focussed on efficient and correct decision making, not on the costs associated within the NOMs delivery and methodology. The Totex Incentive Mechanism is already in place to safeguard consumers from companies making inefficient decisions, while ensuring that both consumers and companies can benefit from efficient decision making over the length of the price control.

Therefore, we recommend that Ofgem derives the associated costs of any over/under-delivery based on the final allowances used in the RIIO-ED1 Business Plans.

Question 5: Do you agree with the use of the actual spend profile for allocating the associated costs of a justified over-delivery or unjustified under-delivery? Are there other options that you consider would be more appropriate? Please state your rationale alongside any answers provided.

SSEN agrees with the use of the actual spend profile for allocating the costs of a justified over delivery or an unjustified under delivery. This is due to the inherent difficulties in exactly identifying the timing of the allowances which relate to the specific risk reduction work. It is necessary that the financial handbook drafting is undertaken as part of establishing the close out methodologies to ensure any financial adjustment is set out clearly and consistently. We would also like to ensure that "double counting" is reflected in any Handbook modifications similar to DPCR 5 close out methodologies.

We had also considered a flat pro-rating for the allocation of these costs, but given the effect that the sharing factor has on over or under delivery, we feel on balance that the use of the actual spend profile is the most pragmatic solution.

Question 6: Do you consider that the timeline proposed is achievable and realistic? Are there improvements that you can recommend? Please state your rationale alongside any answers provided.

We are generally comfortable with the proposed timeline and feel this is achievable and realistic. This timeline is still potentially stretched given the substantial level of work that is required to finalise NOMs work across several of the sectors, and rebasing exercises that still require to be done in both the Electricity Transmission and Gas Transmission sectors.

As we have previously established, the level of expert resource required in this area to ensure a satisfactory conclusion should not be underestimated, and this level of ongoing work is acknowledged by Ofgem throughout this consultation document.

While there are likely to be considerable pressures across both Ofgem and Licensees in the NOMs area until the end of the price control, we feel that a 15 month period from the end of the RIIO-1 price controls for both Ofgem and Licensees to complete the NOMs incentive works should be sufficient.

Question 7: Do you consider that the implementation of a common NOMs incentive methodology should require an impact assessment? Please state your rationale alongside any answers provided.

We do not believe an impact assessment (IA) is required for the implementation of a common NOMs incentive methodology for the Electricity Distribution sector. The Electricity Distribution sector rebased in this area during 2015/16 to the Common Network Output Indices Methodology, and most of the factors involved in a potential impact assessment are already well established and understood.

However, we could understand if other sectors, such as Transmission and Gas Distribution, who have not yet finalised their Common Network Output Measures Methodology and are in year six of an eight-year price control may consider an IA necessary.