

|                                                                                                                             |                                         |
|-----------------------------------------------------------------------------------------------------------------------------|-----------------------------------------|
| Title: Connections volume driver<br>Project: MPR parallel work<br>Division: Networks<br>Team: RIIO Electricity Transmission | <b>Impact Assessment (IA)</b>           |
|                                                                                                                             | Date: 03/3/2017                         |
|                                                                                                                             | Stage: <b>Final</b>                     |
|                                                                                                                             | Source of intervention: <b>Domestic</b> |
|                                                                                                                             | Type of measure: <b>Price control</b>   |
| Contact for enquires: Arun Quayum                                                                                           |                                         |

## Impact of proposals on Ofgem’s Strategic Outcomes

| Strategic Outcomes                                               | Overview of Impact                                                     |
|------------------------------------------------------------------|------------------------------------------------------------------------|
| Lower bills than would otherwise have been the case.             | The preferred option is likely to result in lower bills for customers. |
| Reduced environmental damage both now and in the future.         | N/A                                                                    |
| Improved reliability and safety.                                 | N/A                                                                    |
| Better quality of service, appropriate for an essential service. | N/A                                                                    |
| Better Social Outcomes                                           | N/A                                                                    |

|                          |          |
|--------------------------|----------|
| Quality Assurance Status | Reviewed |
|--------------------------|----------|

## **Summary:** Intervention and Options

Rationale for intervention, objectives and options

### **What is the problem under consideration?**

SPT's price control includes a connections volume driver that funds connections based on the specific assets installed from a menu included in its licence.

Since final proposals there has been an increased need for connections in different locations than anticipated. SPT claims this requires different assets from those specified in the licence. If no change to the volume driver is made no allowance would be provided for installing these alternative assets.

SPT has requested new assets be added to the volume driver. This will mean customers will fully fund the deployment of these additional types of assets.

### **What are the policy objectives and intended effects?**

Our principal objective is to protect the interests of existing and future consumers in relation to gas conveyed through pipes and electricity conveyed by distribution and transmission systems.

We do this through our RIIO model, which is designed to encourage network companies to seek out value for money delivery solutions. We recognise the importance of regulatory confidence and therefore do not make adjustments to price controls unless there is a strong rationale for doing so. We said we would only consider using ex post adjustments if outputs are not delivered or if we have a concern that a company has manifestly wasted money.<sup>1</sup>

### **What are the policy options that have been considered, including any alternatives to regulation? Please justify the preferred option (further details in Evidence Base)**

1. Do nothing– This maintains our price control position. We prefer this approach as we think that changing the revenue driver be asymmetric to consumers. It would provide additional funding to SPT where it

---

<sup>1</sup> Ofgem 2010, *Handbook for implementing the RIIO model*, pp 83-84

overspends the price control settlement while leaving underspends elsewhere unchanged.

2. Change the volume driver – This alters the volume driver so that the all connections are fully funded by customers increasing allowances by around £81 million.

### Monetised Impacts (£m)

|                                             |            |
|---------------------------------------------|------------|
| Business Impact Target Qualifying Provision | N/A        |
| Business Impact Target (EANDCB)             | N/A        |
| <b>Net Benefit</b>                          | <b>N/A</b> |

### Hard to Monetised Impacts

**Describe any hard to monetised impacts, including mid-term strategic and long-term sustainability factors.**

**Perverse incentives-** We also note that SPT could seek to build assets currently included in the connections volume driver mechanism, as these assets will receive funding.

|                                                                                                  |                                            |
|--------------------------------------------------------------------------------------------------|--------------------------------------------|
| <b>Will the policy be reviewed?</b> Yes, as part of setting the next transmission price control. | <b>If applicable, set review date:</b> N/A |
|--------------------------------------------------------------------------------------------------|--------------------------------------------|

**Summary:** Analysis & Evidence

Policy Option 1

FULL ECONOMIC ASSESSMENT - Do nothing (preferred option)

|                                                                                                                                                                                                                                                                                        |                                             |                     |                                                             |                                         |                       |
|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|---------------------------------------------|---------------------|-------------------------------------------------------------|-----------------------------------------|-----------------------|
| <b>Price base year:</b><br>2009/10                                                                                                                                                                                                                                                     | <b>Base Year:</b>                           | <b>Time Period:</b> | <b>Net Benefit (£m)</b>                                     |                                         |                       |
|                                                                                                                                                                                                                                                                                        |                                             |                     | <b>Low:</b>                                                 | <b>High:</b>                            | <b>Best Estimate:</b> |
| <b>COSTS (£m)</b>                                                                                                                                                                                                                                                                      | <b>Total Transition</b><br>(Constant Price) | Years               | <b>Average Annual</b><br>(excl. Transition)(Constant Price) | <b>Total Cost</b><br>(Present Value)    |                       |
| <b>Best Estimate</b>                                                                                                                                                                                                                                                                   |                                             |                     |                                                             |                                         |                       |
| <b>Description and scale of key monetised costs by 'main affected groups'</b><br>SPT may be required to spend more than the allowance the connections volume driver provides.                                                                                                          |                                             |                     |                                                             |                                         |                       |
| <b>Other key non-monetised costs by 'main affected groups'</b><br>We also note that SPT could seek to build assets currently included in the connections revenue volume driver mechanism, as these assets will receive funding, this would lead to higher costs for consumers and SPT. |                                             |                     |                                                             |                                         |                       |
| <b>BENEFITS (£m)</b>                                                                                                                                                                                                                                                                   | <b>Total Transition</b><br>(Constant Price) | Years               | <b>Average Annual</b><br>(excl. Transition)(Constant Price) | <b>Total Benefit</b><br>(Present Value) |                       |
| <b>Best Estimate</b>                                                                                                                                                                                                                                                                   |                                             |                     |                                                             |                                         |                       |
| <b>Description and scale of key monetised benefits by 'main affected groups'</b>                                                                                                                                                                                                       |                                             |                     |                                                             |                                         |                       |
| <b>Other key non-monetised benefits by 'main affected groups'.</b><br>This protects consumers from asymmetric re-opening of the price control and encourages network companies to seek out value for money delivery solutions.                                                         |                                             |                     |                                                             |                                         |                       |
| <b>Key Assumptions/sensitivities/risks</b>                                                                                                                                                                                                                                             |                                             |                     |                                                             | <b>Discount rate (%)</b>                |                       |
| <b>BUSINESS ASSESSMENT (Option1)</b>                                                                                                                                                                                                                                                   |                                             |                     |                                                             |                                         |                       |
| Direct impact on businesses (EANCB)                                                                                                                                                                                                                                                    |                                             |                     |                                                             | <b>Score £m: N/A</b>                    |                       |

**Summary:** Analysis & Evidence

Policy Option 2

FULL ECONOMIC ASSESSMENT - Change the volume driver

|                                                                                                                                                                                                                             |                                             |                     |                                                             |                                         |                       |
|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|---------------------------------------------|---------------------|-------------------------------------------------------------|-----------------------------------------|-----------------------|
| <b>Price base year:</b><br>2009/10                                                                                                                                                                                          | <b>Base Year:</b>                           | <b>Time Period:</b> | <b>Net Benefit (£m)</b>                                     |                                         |                       |
|                                                                                                                                                                                                                             |                                             |                     | <b>Low:</b>                                                 | <b>High:</b>                            | <b>Best Estimate:</b> |
| <b>COSTS (£m)</b>                                                                                                                                                                                                           | <b>Total Transition</b><br>(Constant Price) | Years               | <b>Average Annual</b><br>(excl. Transition)(Constant Price) | <b>Total Cost</b><br>(Present Value)    |                       |
| <b>Best Estimate</b>                                                                                                                                                                                                        |                                             |                     |                                                             |                                         |                       |
| <p><b>Description and scale of key monetised costs by 'main affected groups'</b><br/>Consumers will fund an additional £81 million (SPT estimate) of shared use connections if changes are made to the volume driver.</p>   |                                             |                     |                                                             |                                         |                       |
| <p><b>Other key non-monetised costs by 'main affected groups'.</b><br/>This could harm consumers regulatory confidence, as it would shift the risk of higher costs from SPT to them.</p>                                    |                                             |                     |                                                             |                                         |                       |
| <b>BENEFITS (£m)</b>                                                                                                                                                                                                        | <b>Total Transition</b><br>(Constant Price) | Years               | <b>Average Annual</b><br>(excl. Transition)(Constant Price) | <b>Total Benefit</b><br>(Present Value) |                       |
| <b>Best Estimate</b>                                                                                                                                                                                                        |                                             |                     |                                                             |                                         |                       |
| <p><b>Description and scale of key monetised benefits by 'main affected groups'</b></p>                                                                                                                                     |                                             |                     |                                                             |                                         |                       |
| <p><b>Other key non-monetised benefits by 'main affected groups'.</b><br/>Companies are funded for building the most efficient assets and there are less perverse incentives for companies to build inefficient assets.</p> |                                             |                     |                                                             |                                         |                       |
| <b>Key Assumptions/sensitivities/risks</b>                                                                                                                                                                                  |                                             |                     |                                                             | <b>Discount rate (%)</b>                |                       |
| <b>BUSINESS ASSESSMENT (Option1)</b>                                                                                                                                                                                        |                                             |                     |                                                             |                                         |                       |
| Direct impact on businesses (EANCB)                                                                                                                                                                                         |                                             |                     |                                                             | <b>Score £m:</b>                        |                       |

## Evidence Base

### 1. Scope of this IA

We have decided to produce an IA for this issue as SPT has requested a significant increase in allowances (£81 million). This IA intends to draw out the benefits and costs of each option. The MPR parallel work consultation published alongside this goes into more detail.

### 2. Problem and rationale for intervention

SPT is required to connect generators to its electricity transmission network. The number and cost of these connections is difficult to forecast. A volume driver was introduced to manage this uncertainty.

The price control splits funding for generator connections based on how many generators are linked. There are sole use connections (one generator) and shared-use connections (multiple generators).

SPT is provided with a £112 million allowance to connect up to 1073 MVA of shared-use connections. Any shared-use connections above this threshold are funded through a 'connections volume driver' that provides a set amount of funding based on the assets used to make a connection.

In its business plan SPT forecasted to deliver 1073 MVA of shared use infrastructure over RIIO-T1. SPT now forecasts to deliver 4229 MVA of shared use infrastructure to connect new generation to the network. Much of this increase has been seen in concentrated areas. For example in the Coalburn/Linmill area over 800 MW is contracted to connect compared to the expected 70 MW at the time of the original submission.

SPT has requested that we add the new asset solutions to the connections volume driver mechanism. This will provide funding for deploying the assets which SPT suggests are the most efficient solutions.

SPT reports that due to the change in location and quantity of connections, different types of assets will be required. For example, increasing the capacity of existing lines rather than building new ones. These assets are not included in the current connections volume driver. This means that SPT will receive no funding if these assets are installed. Any costs that are incurred will be considered an overspend and shared with consumers through the total expenditure sharing mechanism.<sup>2</sup>

### 3. Policy objective

Our principal objective is to protect the interests of existing and future consumers in relation to gas conveyed through pipes and electricity conveyed by distribution and transmission systems.

We do this through our RIIO model, which is designed to encourage network companies to seek out value for money delivery solutions. We recognise the importance of regulatory confidence and therefore do not make adjustments to price controls unless there is a strong rationale for doing so. We said we would only consider using ex post adjustments if outputs are not delivered or if we have a concern that a company has manifestly wasted money.

---

<sup>2</sup> Ofgem 2010, *Handbook for implementing the RIIO model*, pp 83-84

#### **4. Which parties may be affected?**

Other than consumers, the main affected group is SPT. SPT may go partly unfunded for installing efficient solutions as these assets are not included in the volume driver. This will be considered as an overspend and shared through the totex incentive mechanism.

#### **5. Options and calculation of monetised impacts**

We have considered two options;

- Do nothing

We recognise that SPT may be required to spend more than the funds the connections volume driver provides. However, this is no different to SPT being required to spend more than what a fixed allowance provides. We also see this risk as being similar to SPT needing to do additional work that was not foreseen or the scope of a project expanding resulting in an overspend. SPT bears this risk in a price control settlement.

- SPT's recommended option to change the volume driver to include new asset solutions.

The advantage of this option is that it removes perverse incentives. However, this option could result in consumers potentially providing as much as £81 million additional funding. This transfers the risk of higher costs from SPT to consumers (while allowing SPT to retain the benefits from underspends). We do not think that adding new asset solutions to the licence would be in consumers' interests.

#### *Conclusion*

We consider that we should treat overspends the same as we treat underspends. If we make no changes in areas where SPT expects to underspend we should also make no changes in areas SPT expects to overspend. To do otherwise would be asymmetric and unfair to consumers. It would leave the risk of higher costs solely on consumers while allowing SPT to benefit from lower costs elsewhere in the price control.

For example SPT has a £112 million allowance to connect up to 1073 MVA of shared-use connections, and it forecasts spending £72 million to reach this. We do not intend on clawing back this £40 million underspend, and similarly would not intend to increase allowances for overspends.

We have proposed the do nothing option in order to protect consumers.

#### **6. Wider impacts and Risks and uncertainties**

##### *Perverse incentives*

We also note that SPT may seek to build assets currently included in the connections volume driver mechanism, as these assets will receive funding. We note that building these assets may not be the most efficient solution. We expect SPT will install the most efficient assets and focus on delivering long-term value for money for consumers as required by its licence. If however, this is not the case we will consider conducting an ex-post review and may remove any inefficient expenditure.