Ofgem consultation

RIIO-ED1: Draft determinations for the slow-track electricity distribution companies - Financial Issues

SP Energy Networks Response

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Annex 2: Response to Financial Issues Consultation

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OVERVIEW

We welcome the opportunity to comment on Ofgem's slow track draft determination for RIIO ED1 – Financial Issues – published on 30th July 2014. The main elements of our response are contained in the SP Energy Networks Executive Summary document.

1. STRUCTURE OF SPEN'S RESPONSE

1.1 Our response to the Ofgem Consultation: RIIO-ED1: DRAFT DETERMINATION FOR THE SLOW TRACK COMPANIES – OVERVIEW, contains an Executive Summary of the main concerns that are most critical to SPD and SPM (collectively SPEN) arising from all of the elements of Ofgem's consultation.

1.2 The purpose of this document is to focus specifically on the issues arising from the questions raised in the RIIO ED1 Financial Issues Consultation.

1.3 We have sought to deal with these topics broadly in the same order as the questions raised in the Consultation. We have referred to the questions in the Consultation in the section headings (by cross referencing with the chapter number and question number).

1.4 A full table of contents follows this section.

In this document we cross refer to various documents. The table of contents on page 3 lists such documents and where these documents have not already been provided to Ofgem they are provided as further appendices to this document.

QUESTIONS RESPONSE

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3. Chapter Two – allowance for the cost of capital

2.1 Please refer to our overview 'SPEN draft determination overview' chapter five – assessment of efficient finance:

2.2 Section 5.1 for our response to Question 1: Do you agree with our cost of equity proposals?

2.3 Section 5.2 for our response to Question 2: Do you agree with our cost of debt proposals?

3. Chapter Three – financiability

3.1 Please refer to our overview 'SPEN draft determination overview' chapter five – assessment of efficient finance section 5.3 for our response to Question 3: What are your views on our assessment of financeability?

4. Chapter Five – taxation

4.1 We welcome the revised roll forward of tax pools on a notional basis from ED1 to ED2. This is consistent with proposals we made previously. We also consider the use of company specific tax pool allocations to be appropriate.

4.2 We propose the dead band for the tax trigger which is the greater of a one per cent change in the rate of mainstream corporation tax (CT) and a change of 0.33 per cent in base demand revenues is amended. It is only appropriate in ED-1 to use a dead band of one per cent change in the rate of mainstream CT. In other industry price controls the materiality of 0.33 per cent in base demand revenues and one per cent change in the rate of CT would have been more closely aligned.

4.3 Under the current proposal the CT rate would have to change by at least 3% before there is a revenue adjustment due to the materiality threshold of 0.33 per cent in base demand revenues in ED-1 being considerably higher than one per cent change in the rate of mainstream CT.

5. Chapter Six – pensions

5.1 With regard to section 6 (Pensions) of the RIIO-ED1 draft determination, we are in general comfortable with the summary of the process for assessing and reviewing pension costs. The only comments we would make are as follows –

5.2 Section 6.7 – Paragraph (i) – This should also make reference to "Updated Valuation" to cover situations where a triennial valuation is not available at the assessment date.

5.3 Paragraph 6.7 (iii). Our understanding is that this paragraph has been included to address the situation where the regulatory share of actual deficit repair payments is significantly different from the allowances calculated under the PDAM.

This may arise where the actual deficit agreed following the triennial valuation date is significantly higher or lower than that at the assessment date. For instance as a result of lower or higher than expected investment returns to the point of agreeing the schedule of contributions (SOC) or updated valuation or through the use of future asset out performance in the SOC over and above that assumed in the technical provisions basis. In these circumstances, the actual deficit used to calculate the repair payments would be higher or lower than that at the assessment date and so it may be appropriate for the licensee and Ofgem to agree to an alternative PSED.

5.4 However, this would not cover the situation where deficit repair payments are significantly different to allowances due to longer or shorter recovery periods. It would be helpful to understand whether Ofgem would also consider making adjustments to the EDE to allow for this issue where significant.

For instance, we recommend the inclusion **under 6.10** of the addition wording **'**or the bilateral discussions referred to in 6.7 (iii)'. A**s follows** –

"The setting of EDE allowances will include adjustments relating to the licensee's actual PSED repair payments history compared to its allowances and possibly adjustments resulting from Reasonableness Reviews" <u>or the bilateral discussions referred to in 6.7 (iii).</u>