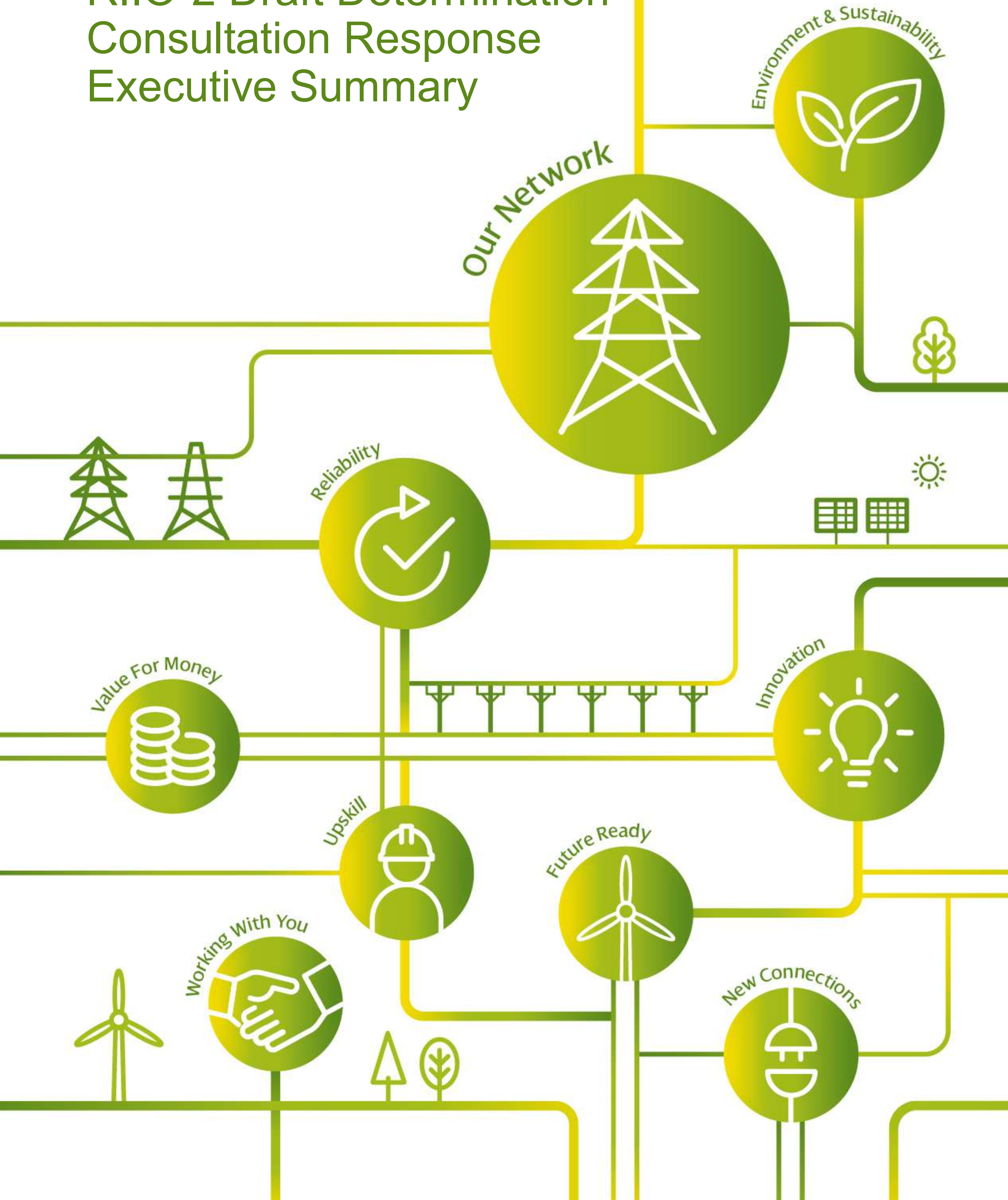
SP Energy Networks
4th September 2020

SP ENERGY NETWORKS

RIIO-2 Draft Determination Consultation Response Executive Summary



Chapter 1: Executive Summary

Key messages

1.1 We consider the RIIO-T2 Draft Determination to be unacceptable for SP Transmission due to:

- The returns proposed in the RIIO-T2 Draft Determination are the lowest in UK history for this sector and well below those available against comparators who are competing to attract similar investment such as the United States of America;
- This Draft Determination will not deliver the Green Economic Recovery at pace to support the UK and Scottish Government's ambition in response to the economic impact of COVID-19;
- The expenditure adjustments and nature of the uncertainty mechanisms does not provide investors with confidence and will ultimately slow down the ability for new renewable generation to be connected thus directly hindering the government's targets for Net Zero; and
- Our Business Plan created opportunities and benefits beyond only the electricity transmission network which have been removed in the Draft Determination. This is a missed opportunity to create job opportunities, economic growth across the energy sector in Great Britain, reducing the environmental impact of our operations and the subsequent health benefits that this creates through more renewable generation being connected and improved bio-diversity.

Introduction

1.2 This is SP Transmission's (**SPT**) response to Ofgem's RIIO-T2 Draft Determination. SPT holds transmission licence for the south and central Scotland. SPT is part of SP Energy Networks (**SPEN**) and the Iberdrola group. Whilst this is SPT's response to the Draft Determination, the decisions made by Ofgem as part of the wider RIIO-2 framework may have an impact on other parts of SPEN's business.

1.3 At a point in time when significant investment in the transmission network is critical to ensure the successful transition to Net Zero for Great Britain, Ofgem has impaired this objective through the Draft Determination it has proposed for RIIO-T2. Ofgem has reduced SPT's allowances through the adjustments in the Draft Determination which will be to the detriment for the connection of new generation, reducing system constraints, and ensuring we retain GB's world class network for reliability. This will impact system reliability and slow down growth in renewable generation and the adoption of other low carbon technologies.

1.4 As we write this response, we are reflecting on the announced closure of Hunterston Nuclear Power Station and the implications for the wider aging fleet across our country that will require an ability for Electricity Transmission Networks to have the headroom to cope with large uncertainty and maintain high levels of security of supply. This only demonstrates the rapid changes that our electricity transmission network needs to respond to and the need for innovative solutions as outlined in our Business Plan such as Synchronous Compensation as well as conventional reinforcement of the system as a whole.

1.5 We cannot deliver our Business Plan with the adjustments detailed in the Draft Determination. Without addressing the points identified in this response, we will have no option other than to revisit the scope of projects and operational activities we have set out in our plan.

1.6 The Draft Determination is manifestly flawed and if implemented, we are advised that it is clearly appealable to the Competition and Markets Authority, (**CMA**). However, an appeal is not inevitable, and our preference would be to work constructively with Ofgem in order to resolve these differences, thereby avoiding the need for an appeal, and, at a minimum ensure that we have worked together to properly narrow and focus the areas of dispute. We are committed to continue to work constructively with Ofgem on these matters.

1.7 In this document we set out why Ofgem's Draft Determination is wrong. We also set out the material adverse consequences that will result from its implementation. We have material concerns that, if implemented, the Draft Determination puts at risk SPT's ability to adhere to its statutory duties. We are continuing to assess this risk.

1.8 The number of errors, inconsistencies, flaws and unjustified changes to our plan have led to a complete loss of confidence in the process, the model being used and in Ofgem's decision making. It is therefore essential that Ofgem give us a revised draft determination, by early October correcting these mistakes and reversing the £15m business plan penalty, to restore confidence and faith in the process.

1.9 In the main body of our response below, we have categorised our arguments into six key areas namely,

i. Material errors in SPT's proposed total expenditure allowances

ii. Ofgem's proposed ongoing efficiency stretch is not supported by evidence and is a "double count" of SPT's embedded efficiencies

iii. Ofgem's Business Plan Incentive is based on an arbitrary assessment of low and high Confidence Costs

iv. Uncertainty & Incentive Mechanisms must be revisited to achieve Net Zero

v. Ensuring SPT remains financeable

vi. Ofgem's procedural failings

1.10 Ofgem's Draft Determination contains a range of material errors and inconsistencies. In relation to Ofgem's Totex adjustments, many of these are erroneous, overlook stakeholder support, and use a flawed benchmarking approach. Ofgem has incorrectly calibrated uncertainty mechanisms that do not adequately remunerate the costs that Electricity Transmission Owners (**TOs**) would reasonably expect to incur for generation connections, and many practical considerations have not been accounted for such as the timing of re-openers for further expenditure to be proposed.

1.11 The combination of Ofgem's proposals materially increase risks for SPT and reduce any prospect of rewards for achieving outcomes that provide demonstrable benefits consistent with our legal duties and objectives. By way of example, Ofgem have introduced the following new mechanisms or substantial changes in comparison to the existing RIIO-1 regime:

Table 1: New Mechanisms and Changes Comparative to RIIO-1

Policy Area	Risk
Business Plan Assessment	The operation of the new methodology for assessing the Business Plans, is highly subjective and penalises companies based on an opaque set of benchmarks. Also, companies are exposed to ex-post adjustments for the Business Plan Incentive through Consumer Value Propositions.
Allowed Versus Expected Returns	The creation of an adjustment to account for allowed versus expected performance which is an arbitrary and unprecedented adjustment, unreflective of future performance.
Return Adjustment Mechanisms	RAMs will cap the performance of companies and claw back any further outperformance, thus blunting TOs' incentive to find efficiencies which are then shared with consumers.
Competition Models	The introduction of three new and ambiguous competition models which will impact

	future large-scale investments, without any evidence of benefits to consumers.
Level of Returns	The reduction to the cost of capital to an all-time low for GB networks will not attract the necessary investment to support the UKs green recovery.
Incentives (ODIs)	A significantly reduced and asymmetric package, with a significant downside and little upside. This will incentivise "safety first" behaviour by TOs when innovation is required. It will not incentivise changes required for Net Zero and will place an unreasonable liability on TOs.
Pre-construction	New mechanisms result in greater risk being borne by TOs for pre-construction, despite the criticality of such projects being higher than ever before for Net Zero and security of supply reasons.
Large Project Delivery	A new Project Delay Charge as part of the Large Project Delivery incentive will penalise TOs for delays due to matters outside their control. This unfairly exposes companies to risks outside of their control.
Stakeholder Engagement Process	It is not clear to us that Ofgem have utilised the more complex stakeholder engagement process they have created and failed to reflect the views of the User Group and Ofgem's own Challenge Group.
Ex-Post Price Control Deliverables (PCDs)	Ofgem are suggesting that there could be an after the event adjustment to allowances if PCDs are not delivered in accordance with the Final Determination.

1.12 This response has been assured by independent subject matter experts where relevant and is accompanied by a Board Assurance Statement. In developing this response, we have participated in a number of RIIO-2 engagement sessions with Ofgem and sought feedback from our Transmission User Group and our stakeholders on the Draft Determination. This response to the Draft Determination takes account of those sessions and that feedback.

Background

1.13 In December 2019, SPT submitted its final RIIO-T2 Business Plan to Ofgem. The plan had been extensively informed by views from stakeholders as well as technical and subject matter experts. All elements of the plan were subject to thorough assurance including Board approval in addition to significant external oversight by the User Group and the RIIO-2 Challenge Group. The plan is built on our track record of accurate and careful planning, demonstrated by our delivery of our RIIO-T1 plan.

1.14 The User Group described our plan as "*an evidence-based, cost-effective Business Plan".[1]* Other comments included the following:

> "*we are more than satisfied that the Business Plan provided by SPT will deliver sufficient investment to keep the system at its exceptional levels of reliability, whilst also undertaking a significant part of the work required to deliver Net Zero*"[2]
>
> "*SPT has built a strong plan built on good principles that takes into account key stakeholder ambitions and targets.*"[3]

1.15 Ofgem's Consumer Challenge Group (CCG) was clear that SPT's plan was one of the best plans,[4] and our plan scored well. The CCG said:

> *"We found SPT's plan to be very accessible. Overall, we find expenditure in the SPT plan to be well justified".*[5]

[1] Independent Transmission User Group Report, SP Energy Networks RIIO-T2 Business Plan 2021-2026, page 9
[2] Independent Transmission User Group Report, SP Energy Networks RIIO-T2 Business Plan 2021-2026, page 6
[3] Independent Transmission User Group Report, SP Energy Networks RIIO-T2 Business Plan 2021-2026, page 25
[4] RIIO-2 Challenge Group Independent Report for Ofgem on RIIO-2 Business Plans, 24 January 2020, page 3
[5] RIIO-2 Challenge Group Independent Report for Ofgem on RIIO-2 Business Plans, 24 January 2020, page 36

"The Plan takes a fairly comprehensive approach to scenario planning based upon CCC analysis. Scenarios look beyond energy to cover heat and industry and cover a range of network issues – and some projects in these areas (e.g. black start) appear to genuinely go beyond RIIO-1. The Plan also proposes forward-thinking solutions (taking a strategic rather than a traditional incremental approach)".[6]

1.16 The feedback from the User group and Challenge Group provided positive feedback and we formed a reasonable expectation that our plan was viewed as high quality. The aim of the Business Plan Incentive is to reward high quality plans. The proposed penalty of £15 million was, therefore, entirely unexpected and is unjustified. We were also surprised by the proposed material reduction to our investment programme and the rejection of many of our proposals to protect the environment and the interests of consumers. If the Draft Determination is implemented, it will have material adverse consequences for SPT, and also critically, it is not in the interests of existing and future consumers; this is not consistent with Ofgem's objectives and duties.

Material errors in SPT's proposed total expenditure allowances

1.17 We believe the Draft Determination included significant errors which will compromise the interests of consumers and facilitating the transition to Net Zero.

1.18 In our Business Plan, we have only embedded those activities with the highest certainty, and criticality that require intervention in the T2 period. We proposed uncertainty mechanisms for those schemes not in our baseline plan, so that investment only takes place when their certainty increases to a point where a commitment is required. This approach is consistent with Ofgem's stated preference in the Draft Determination and is in sharp contrast to other electricity network operators' Business Plans.

1.19 For our load related investment, our high confidence baseline translated to 900MW of new transmission connections and 2027MVA of capacity to support these new connections. Whilst we are contracted to connect over 5,000MW of generation in the T2 period and create more than 8000MVA of capacity, rigorous assessment criteria agreed with stakeholders, helped us to allocate projects to our baseline or uncertainty mechanisms.

1.20 For our non-load related expenditure, we continue to utilise our high-quality asset data, in which the Ofgem engineering team told us they had high confidence, before our Business Plan was submitted. This helps to ensure we are making interventions at the optimal point in the assets' lifecycle. We have also pursued a wide range of interventions, rather than only replacement. For example, we are making far greater use of transformer refurbishment (instead of replacement) than other TOs. As a result of this, we are now replacing 0.2% of our transformer and reactor fleet in T2. For our other main asset classes, the turnover rate is largely similar, ranging between 0.2-1%.

1.21 For the management of our transformers alone, this has created a saving to consumers of £26m through refurbishment rather than full replacement in the RIIO-T2 period. It is only through our expert asset management and diligent stewardship that we can maximise the value from these assets and keep the costs of the transmission network low.

1.22 We have material concerns that the errors and adjustments made to our plan puts at risk our ability to fully meet our statutory and licence obligations as a network owner. Following our analysis, we believe that the components below make up for the differences between our Business Plan expenditure and Ofgem's Draft Determination value.

[6] RIIO-2 Challenge Group Independent Report for Ofgem on RIIO-2 Business Plans, 24 January 2020, page 186

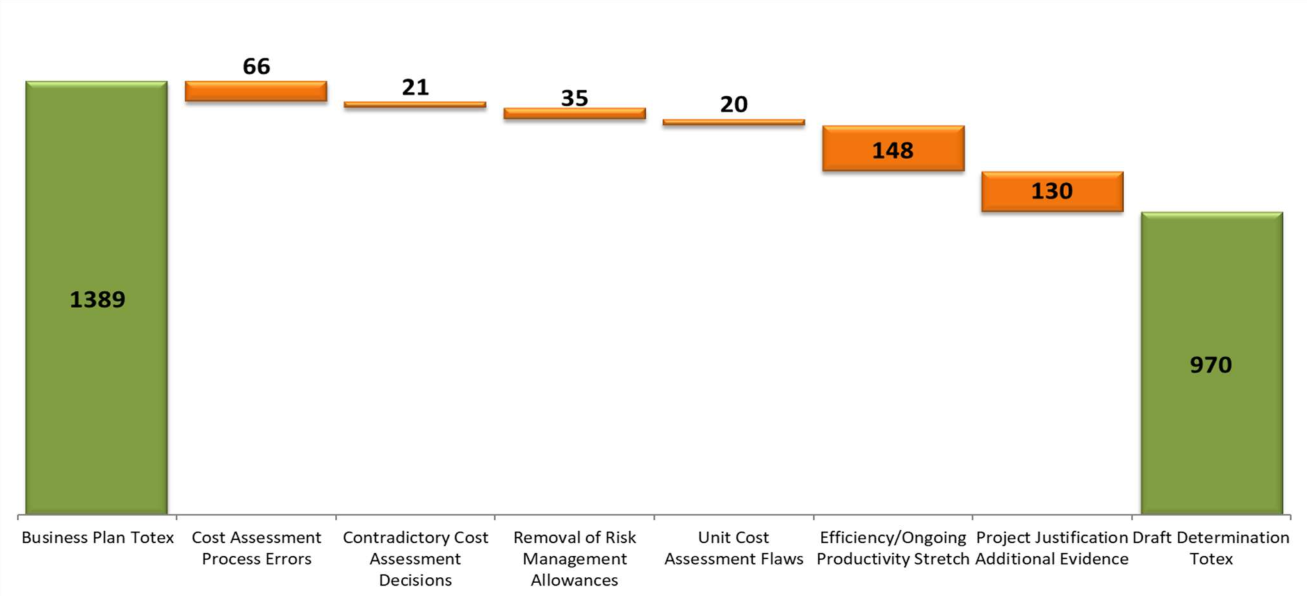


Figure 1: Waterfall Diagram of SPT's Business Plan TOTEX v Ofgem's DD

1.23 Our review of the Draft Determination has uncovered a range of errors and inconsistencies in Ofgem's cost assessment process, as illustrated in Figure 1 based on our interpretation of the values included in the Draft Determination. Some examples are as follows:

i. **Errors in the cost assessment process - £66m.** In our review of the cost assessment models Ofgem has provided us with, we have identified errors including: engineering evidence being overlooked; incorrect references to the SPT Business Plan; and reductions due to the operation of the model failing to reflect Ofgem's own guidance for completing Data Tables. All but £0.02m of a £4m project to reduce system constraints across boundary B5 have been removed which cannot allow this project to progress.

ii. **Contradictory cost assessment decisions - £21m.** Some results of the cost assessment process are impossible to reconcile with other elements of the Draft Determination. Individual projects have been approved, but the funding has been removed or reduced. For example, The Net Zero Fund is accepted by Ofgem, but its costs were removed by Ofgem's cost model (£20m). The refurbishment of Grangemouth SGT1 was approved, but its costs were removed by Ofgem's cost model (£0.57m).

iii. **Removal of risk management allowances - £35m.** Ofgem has removed 75% of allowances for risk management of our engineering projects. Projects cannot be properly conducted without an adequate allowance for risk management. Ofgem assumes that that if expenditure includes costs beyond RIIO-T2 period, there is no risk exposure in RIIO-T2. This is manifestly wrong, as risks can crystallise at any stage of a project. Ofgem assumes that the risk allowance can be allocated to elements of scheme costs proportionately and that our costs for assets already include out-turn risk. This is not correct, we informed Ofgem that our asset costs are derived from tender and contract award costs. This error by Ofgem has resulted in up to 92% of the risk allowance being removed from some schemes.

iv. **Unit cost assessment flaws - £20m.** Ofgem has applied an inappropriate means of benchmarking costs including inappropriate comparators. For example, Ofgem has used DNO costs to benchmark 33kV cable costs. This is incoherent. DNO 33kV cables are typically designed to carry one quarter of the power compared to a 33kV cable connected to a Grid Supply transformer which a TO is responsible for. The capacity of DNO cables is typically 30MVA or less which can be achieved by a single core-per-phase. TO capacities are up to 120MVA requiring four times the capacity. This immediately leads to multiples of the DNO costs being incurred and is not accounted for. This is only one example of where inappropriate benchmarks have been used to derive Ofgem's view.

v. **Project justifications have been overlooked - £130m**. Our Business Plan included 110 Engineering Justification papers to provide detailed technical evidence on our engineering plans. This was supported by contributions and a thorough review through various technical and subject matter experts to support this. These were completed in accordance with the Ofgem guidance and the majority of these have been accepted. We have submitted a well justified Business Plan. Some of our projects have been rejected on the basis of insufficient evidence despite the Ofgem guidance not specifying an engineering justification as being required. For example, costs associated with managing servitudes is expenditure we have always incurred and is necessary for the management of our assets. Yet this has been rejected on the basis of a lack of justification in our Business Plan. Engineering evidence has also been mis-construed such as the condition reports that we provided for the Torness Shunt reactor which led to these being rejected despite independent experts validating our approach. We have provided Ofgem with 22 further engineering justifications in advance of this response to support Ofgem's analysis and to continue their assessment of these areas.

1.24 In accordance with Ofgem's guidance, our Business Plan Data tables were accompanied by a detailed commentary highlighting issues we had identified where inconsistencies, omissions or ambiguities in Ofgem's guidance and glossary could lead to erroneous assessment. In many cases (in particular Network Operating Costs and Non-Load Related Expenditure), the material errors we have identified in the Draft Determination would have been avoided had Ofgem considered the relevant information submitted by us in this respect. We have seen 22% of Network Operating costs disallowed despite the reasons being cited by Ofgem for such adjustments being clearly explained in our Business Plan Table Commentary for this activity.

Ofgem's proposed ongoing efficiency stretch is not supported by evidence and is a "double count" of SPT's embedded efficiencies

1.25 We have already embedded an ambitious level of efficiency to our plan, providing £145m of savings to consumers.

1.26 Ofgem proposes an additional efficiency stretch of 1.2% per year for CAPEX and 1.4% per year for OPEX, which translates to £62m based on the Draft Determination TOTEX value. This does not, however, take into account cost efficiencies which we have already embedded into our Business Plan submission. An efficiency stretch totalling £145m was applied to our baseline plan by SPT. This comprised known efficiencies delivered through our innovation in design, increased utilisation of existing assets and other productivity improvements delivered over the course of T1 (£110m). A further 2.5% (£35m) efficiency stretch was incorporated in the RIIO-T2 baseline plan of £1375m. There is therefore a double count.

1.27 In addition, the ongoing efficiency level as proposed by Ofgem disregards the available evidence and is based on a material overestimation of productivity growth. The OBR reports that annual growth in output per worker (i.e. labour productivity) averaged around 0.3% per annum between 2008 and 2018. It is clear that productivity growth has been lower since the financial crisis. Therefore, if this value was to be applied in absence of embedded efficiencies it should be 0.3% as recommended by NERA utilising market evidence (Please see Appendix 5 for NERA's Ongoing Efficiency report).

1.28 SPT has already embedded greater efficiencies in the Business Plan. Ofgem's proposed ongoing efficiency is not supported by evidence and if retained will constitute a double count.

Ofgem's business plan incentive is based on an arbitrary assessment of lower and high confidence costs

1.29 Our plan was recognised by the Transmission User Group and Challenge Group as being high quality and offering good value. Whilst Ofgem have acknowledged the quality of the plan they have imposed a £15m penalty on SPT.

1.30 We have material concerns about the results of the Business Plan incentive. These flow, to a material extent, from Ofgem's flawed cost assessment process. In particular, Ofgem's classification of costs as "high" or "lower" confidence is arbitrary. Ofgem has disregarded clear evidence submitted by SPT justifying the confidence level in Annex 33 of our Business Plan.

1.31 Ofgem's approach lacks transparency and has the perverse result of penalising precisely the innovative and ambitious proposals that the Business Plan Incentive was ostensibly designed to encourage. For example, the rejection of our circuit ratings management system not only prevents us progressing this innovative project to increase the capacity of our network, but we are further penalised in the Business Plan Incentive as Ofgem has low confidence in their own ability to benchmark it.

1.32 There is a significant disparity between the penalties faced by gas and electricity companies as shown in figure 2. We view this as a result of the failings in the Transmission Cost assessment methodology.

Licensee	Stage 1	Stage 2	Stage 3	Stage 4	Applicable cap/collar (+/- 2% Totex)	Total Reward/Penalty (£m)
Cadent	No penalty	£0m	-£0.1m	£0m	£85.4m	-£0.1m
NGN	No penalty	£1.6m	£0m	£0m	£22.7m	£1.6m
SGN	No penalty	£0m	-£1.1m	£0m	£53.2m	-£1.1m
WWU	No penalty	£0m	£0m	£0m	£21m	£0m
NGGT	-£7.8m	£0m	-£18.6m	£0m	£31.8m	-£26.4m
NGET	-£16.7m	£0m	-£179.6m	£0m	£66.6m	-£66.6m
SHET	No penalty	£0m[132]	-£47.3m	£0m	£32.2m	-£32.2m
SPT	No penalty	£1.6m	-£16.6m	£0m	£19.4m	-£15.0m

Figure 2: Ofgem's BPI Table at Draft Determination [7]

1.33 By way of explanation Ofgem say: "*10.24. We recognise that we have assessed a significantly higher proportion of costs in the Gas Distribution sector as high-confidence costs compared to the Electricity and Gas Transmission sectors. This reflects differences between the sectors in the availability of independent cost benchmarks. The industry structure of the Gas Distribution sector makes it easier to construct independent cost benchmarks, whereas this is not always possible in the Electricity and Gas Transmission sectors.*"[8]

1.34 This is in no way an adequate justification. It penalises transmission companies solely due to the nature of their business, and strongly suggests that the design of the BPI mechanism is flawed as it fails to take account of these differences between the gas and electricity sectors. In the same paragraph Ofgem go on to say: "*However, in our BPG, we set out a number of ways in which companies can support a high-confidence assessment by providing information in their Business Plans. Alongside, other relevant*

[7] Ofgem, RIIO-2 Draft Determinations: Core Document, 9 July 2020, page 123
[8] Ofgem, RIIO-2 Draft Determinations: Core Document, 9 July 2020 paragraph 24

considerations, we have taken account of information provided by companies in their Business Plan submission in reaching our views on cost confidence".

1.35 We cannot reconcile this statement with Ofgem's assessment of our Business Plan. The SPT submission included detailed cost information designed to provide such confidence. This has been rejected for reasons that are unclear. Around 96% of our expenditure is competitively tendered and all our costs are evidence driven and based on this historic experience. The use of a discretionary high or lower confidence metric is irrational, as is the high penalty. Had Ofgem properly addressed the cost assessment process, many more of our costs would have been classified as "high confidence".

1.36 The arbitrary way in which Ofgem proposes to apply the BPI will damage trust in business plan incentives in the future. We submitted a Business Plan that Ofgem told us, before the Draft Determination was published, was well justified. We do not see how the outcome of the BPI is consistent with Ofgem's purported objective of rewarding companies whose plans are high quality.

Uncertainty & Incentive Mechanisms must be revisited to achieve Net Zero

1.37 Ofgem's proposed Uncertainty Mechanisms package will not deliver net zero and will significantly undermine government's objectives to deliver a green recovery. Any delays to the connection of renewable generation will also have a wider societal impact in terms of health benefits and economic growth.

1.38 Our Business Plan addresses the very material consequences of Net Zero for electricity transmission. It focusses on the interests of present and future consumers in the reduction of electricity related emissions of greenhouse gas and the need to contribute to sustainable development. These are all matters that Ofgem is under statutory duties to address. We provided a range of progressive and structured mechanisms for this purpose in our Business Plan, but the Draft Determination does not provide sufficient flexibility or remunerate the costs that we would expect to incur.

<u>Inadequate Uncertainty Mechanisms to support customers' needs</u>

1.39 Our Business Plan proposes uncertainty mechanisms to ensure that when the need for investment crystallises, the funding is approved timeously and efficiently. This need for investment is critical for the transition to Net Zero - to ensure generation is connected in a timely manner, capacity is available for the transmission of power, and the increasing demands for electricity can be met.

1.40 Over the RIIO-T2 price review period, we are contracted to connect over 5000MW of renewable generation, 4100MW more than our baseline plan, which would make an annual saving of more than 3 million tonnes of CO_2 per annum. We only included expenditure proposals in our Business Plan for projects which we had a high confidence would materialise in RIIO-T2. To ensure that currently less certain projects could progress without undue delay, we proposed several uncertainty mechanisms to provide allowances when such projects became more certain. This approach was supported by stakeholders and our User Group.

1.41 During the development of our Business Plan, we engaged with Ofgem on numerous occasions about the design of our proposed mechanisms. Despite this positive engagement, Ofgem has proposed different mechanisms with no clarity as to why our proposals were dismissed. It is unclear how Ofgem assessed the merits and drawbacks of our proposals compared to their own. SPT will be underfunded by £90m if we are to connect the additional 4100MW of generation through the mechanism proposed in the Draft Determination.

1.42 Ofgem has rejected these mechanisms without giving clear reasons and has substituted its own mechanisms. The mechanisms are poorly designed and will likely materially delay projects that are critical to the achievement of Net Zero. Ofgem's proposed mechanisms will not provide adequate funding and contain basic errors. For example, the regression analysis to inform the connections volume driver is based on eight data points out of a total of fifty that we have provided to Ofgem. This is neither statistically robust nor does it provide a representative sample of projects that we may be required to deliver. Further, the models include errors in their operation which creates flawed results.

1.43 The uncertainty mechanisms proposed by Ofgem will create a range of practical difficulties. Ofgem has proposed a 2024 reopener window for several areas under the Medium sized investment project re-opener (MSIP) to cover projects such as those required by the ESO to reduce network constraints. There is a single 2024 application window proposed for such projects to be considered. This will delay any project from progressing in the interim. This will likely materially delay projects that are critical to ensure that the GB transmission system remains fit for purpose so that reasonable demands for electricity are met, the electrification of transport and heating can be supported, and for wider Net Zero purposes. We have proposed that this mechanism should provide an annual re-opener to overcome these risks.

1.44 Other Ofgem objectives and duties will also be impacted by this approach and will negatively affect stakeholders and consumers. The delay to low carbon generation projects creates security of supply issues, will damage competition in the electricity generation market and may affect competition in the upcoming CfD allocation rounds. More generally, the Draft Determination proposals for uncertainty mechanisms do not promote long-term efficiency, create the risk of increased costs for consumers, and provide less certainty for TOs.

The Draft Determination dilutes the successful RIIO-T1 incentive regime

1.45 The proposed ODI package represents a significant dilution of the incentives package which underpins the RIIO model, with penalties three times greater than the potential rewards.

1.46 There are stark differences in the incentives proposed in the Draft Determination between gas and electricity transmission companies. Figure 3 below shows that in gas, the incentive regime is more symmetrical and provides substantially greater upside potential compared to electricity transmission, where companies are more likely to face penalties with little opportunity of reward.

1.47 In RORE terms, Common ODIs Upsides for GDNs (0.4%) are double that of electricity transmission (0.2%) average. Further, the downside risk of 0.8% for GDNs is 28% lower than for TOs who face a 1% downside on average. We cannot identify a sound reason for these stark differences.

1.48 SPT (and RIIO-ET2) incentives are downwardly biased, due to a negative skew towards penalties and a greater magnitude of the negative skew relative to the approach taken in other sectors. Ofgem proposes penalties 4 and 4.5 times higher than rewards for SPT and ET2 respectively, which is considerably greater than penalties for energy networks in RIIO-1 (penalties 1.1 times higher than rewards, i.e. almost symmetrical on average) or water companies at PR14 (penalties 2.6 times higher than rewards) and PR19 (penalties 1.5 times higher than rewards), as illustrated below.

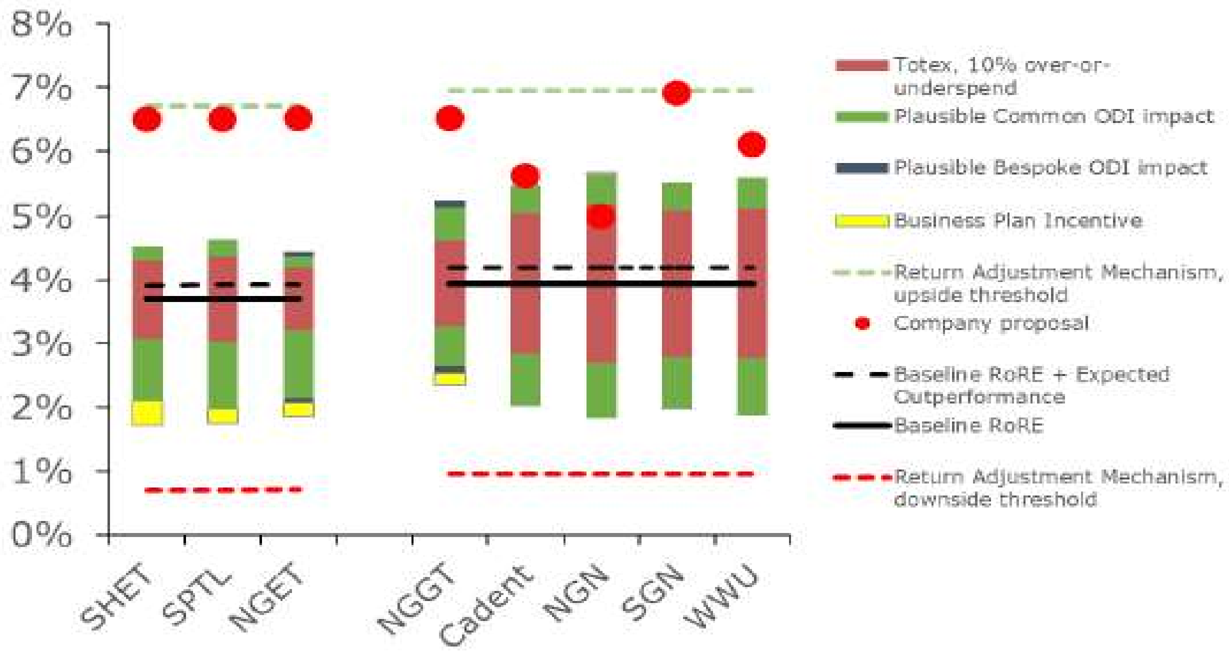


Figure 3: Ofgem's RORE Values at Draft Determination[9]

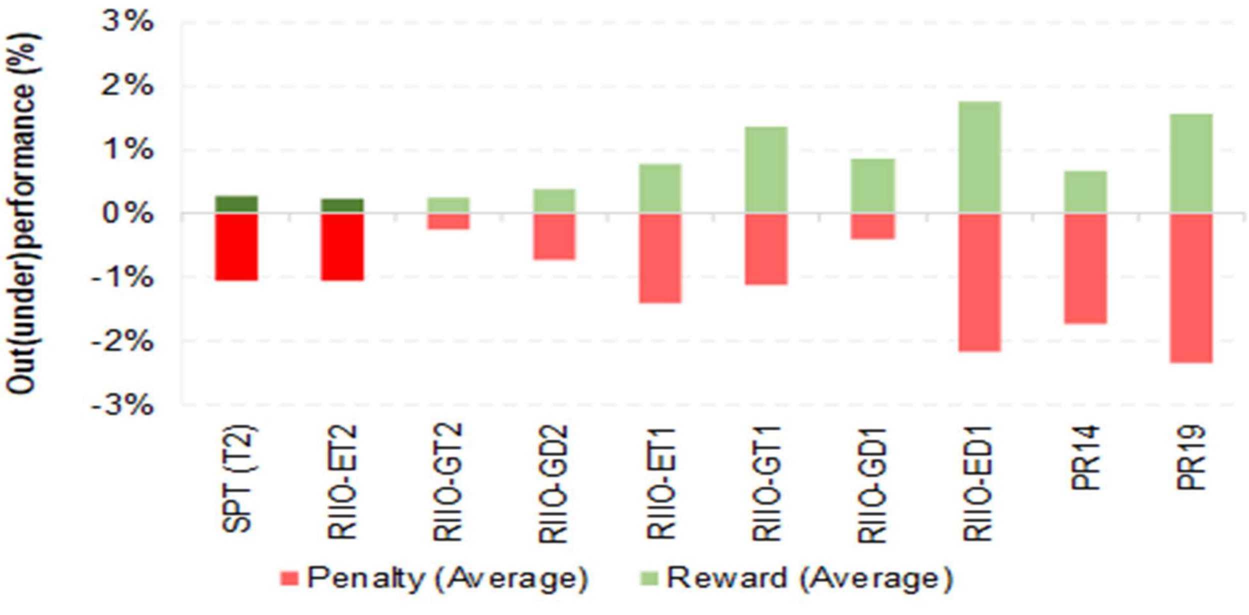


Figure 4: Ofgem's Proposed Asymmetry of Incentive Package for SPT/RIIO-ET2 Is Unprecedented Relative to other UK and historic Regulated Networks

1.49 Ofgem has not yet specified the full range of the output incentive package for the RIIO-T2 period, but from the available ODI information, we forecast (bottom up) that the output incentive range has a downside risk of £12.3m and a maximum upside opportunity of £2.3m per annum. This is compared to a downside of £12.7m and upside of £12.9m for the RIIO-T1 period. This asymmetric risk imposes an unreasonable liability on TOs. The extent of this asymmetric outcome is unprecedented in GB regulation and presents a risk that will undermine investor confidence. Ofgem itself indicates the proposed range could be at 105bps downside and 27bps upside of RORE which translate to c. -£61.8m to +£15.6m over the price control, therefore we

[9] Ofgem's Investor Presentation 9th July

believe there is potentially an inconsistency between Ofgem's RORE ODI ranges and the bottom up incentive calibration.

1.50 The User Group said of our proposed incentive package: "*We believe incentives have made a real and measurable difference in the performance of network companies, including SPT. We support their continued and targeted use in RIIO T2. SPT's proposal builds on experience in T1, enveloping feedback from RIIO T2 engagement, including input from the User Group. We agree that it is a strong package with excellent new additions*."[10]

1.51 Each of our proposed ODIs are supported by customer and stakeholder feedback we have received and used as the basis for our ODI proposals. However, Ofgem has rejected all but one (a reputational one) of our bespoke ODI proposals despite the clear evidence we have submitted[11] to demonstrate all ODI proposals fulfil the criteria set out in Ofgem's September 2019 RIIO-2 Business Plan Guidance[12]. We have demonstrated the positive net present value (NPV) and consumer value proposition (CVP) that each of our financial ODI brings.

Ensuring SPT remains financeable

1.52 In our view, Ofgem's proposals undermine the financeability of electricity transmission by cherry picking arguments. Ofgem have made arbitrary adjustments and fail to reflect fundamental differences in asset betas and risk associated with electricity transmission in comparison to water.

1.53 As a more general point, Ofgem's Cost of Equity proposals are divorced from the real world and do not represent the reality faced by investors. The lack of adequate incentives to investors to commit to crucial investment in the UK and create the required stimulus to enable Net Zero can be evidenced by recent investor news, for example on the 27th August 2020, Barclays published an investor note which stated it would expect National Grid to trade at a 5% discount to RAB based on the proposed Draft Determination parameters. On the same day, S&P have affirmed they had changed National Grid plc's outlook to negative, the key reasons for the negative outlook are the impact of Covid-19 and tougher conditions in the next regulatory period in the UK. As the UK is due to leave the EU within the next 3 months, we believe this will introduce even further risk which has not been factored into Ofgem's academic use of the CAPM.

1.54 Ofgem's proposed finance package does not reflect the increased level of risk that TOs are exposed to, benchmarks poorly with other comparators and includes unjustified adjustments. Predictability and reasonable returns are essential when, now more than ever investment is required in the UK to meet GB's Net Zero objectives. The financial package must be fair to consumers and investors. Fairness to consumers and fairness to investors are not and should not be mutually exclusive, and Ofgem has a duty to balance these objectives. It is in the interests of consumers that utilities can attract the necessary finance. The interests of future consumers is of particular relevance here. Setting an unduly low cost of capital may be viewed, (erroneously) as in the interests of present consumers. However, Ofgem's proposals will damage confidence in the regulatory regime and therefore risks leading to a higher cost of capital in the future. This is manifestly not in the longer-term interest of consumers.

1.55 It is also important to ensure the UK can attract the necessary investment and companies retain their investment grade credit ratings. Ofgem's cost of equity allowance for Electricity Transmission lies below the median of European countries and on an international basis is much lower when compared to the returns available in the US.

1.56 Ofgem's proposed cost of equity puts at risk the significant investment required to ensure network companies can enable the transition to Net Zero as quickly as possible. Worryingly, Ofgem's Draft Determination does not provide adequate signals to investors to commit to the UK and create this stimulus.

[10] User Group Report, page 37
[11] Appendix A: *BESPOKE FINANCIAL ODI CHECKLIST* of Annex 12 of our December 2019 submission https://www.spenergynetworks.co.uk/userfiles/file/RIIO-T2_Annex_12_Output_Delivery_Incentives.pdf
[12] https://www.ofgem.gov.uk/system/files/docs/2019/09/riio-2_business_plans_guidance_september_2019_-_published_0.pdf

1.57 It is imperative that Ofgem set an appropriate Cost of Equity to avoid a similar situation to 1999, where water companies were trading at a large discount to their RAV, due to a market perception of a tough regulatory settlement. It is not in consumers' interests to damage companies' financeability.

Ofgem's view that water companies face similar risks to TOs is wrong

1.58 Water companies are less risky than electricity networks as evidenced by historic asset betas, yet Ofwat has proposed a Cost of Equity for PR19 that is more than 20bps higher than Ofgem's current proposal. Ofgem's proposed finance package does not reflect the increased level of risk that transmission owners are being exposed to, and benchmarks poorly with other comparators. Ofgem argues that pure-play energy networks in GB have several similar risk characteristics as pure-play GB water networks, suggesting that Severn Trent (SVT) and United Utilities (UU) are appropriate comparators for estimating betas for pure play GB energy networks. However, Ofgem's economic advisors, CEPA, in its own report acknowledges that there are some different sector specific drivers of risk that could imply a higher risk for energy networks.

1.59 Both qualitative and quantitative evidence demonstrates that TOs face greater risks than water companies. Whilst the regulatory regimes in energy and water are closely aligned, NERA's comparative risk analysis suggests that investors in SPT face higher risk than investors in water networks (and indeed other energy networks) for the following reasons:

- Empirical data supports persistently higher betas for energy networks (NG, SSE) compared to the water companies (UU, SVT, PNN), suggesting higher risks for energy networks than water companies. National Grid's asset beta is around 0.38 on average higher than water networks.
- Greater system operability risks associated with TOs;
- Greater use of competition models with unknown policy from the outset of RIIO-T2 (further detailed below).

RIIO-2 framework has deteriorated from a risk perspective

1.60 Investors face greater risks under RIIO-2 rather than the RIIO-1 regime, and this is supported by rating agency comments on the riskiness to the regime. Although Moody's maintain its Aaa sub-rating for the stability and predictability of the regime, Moody's recently announced that the framework has deteriorated, as such is credit negative[13], notably given Ofgem's reduction to the allowed return for assumed outperformance. It is of utmost importance to note that investors alike have raised their grave concerns at Ofgem's Draft Determination proposals. Bernstein in its open letter to Ofgem's CEO[14] has stated that "*Network investments can create much needed economic stimulus as well as enabling UK to achieve its Net Zero goal, but the Draft Determination is stuck in "austerity" mode*". It also correctly recognises that Electricity transmission, "*which has been granted the lowest RoE (3.7%), faces the highest disallowance (46% of proposed spend disallowed)*".

1.61 Predictability and fair returns are required at a time where, greater than ever, investment is required in the UK to facilitate GB's Low Carbon Agenda. As a UK based company, we are not only creating employment opportunities, but are also supporting our local economies as a responsible and transparent taxpayer.

[13] Moody's Investor Service: Sector Comment Regulated Energy Networks – UK RIIO-2 proposals support sector's business risk profile, but legitimacy in greater focus 3 August 2020
[14] Bernstein (2020), "An Open letter to the CEO of Ofgem: With great power comes great responsibility ..."

Ofgem's Cost of Debt model is untested and introduced at a time of existing financial uncertainty

1.62 Ofgem propose to update their Cost of Debt index to the iBoxx Utilities 10yr+ index, instead of the average A and BBB 10yr+ iBoxx non-financial indices used in RIIO-1. This is an untested debt index and therefore introduces further risk from unknowns. For example, compared to iBoxx A/BBB, iBoxx Utilities is sector specific and does not have a defined rating (other than investment grade), whereas iBoxx A or BBB indices are regularly updated to include only A or BBB bonds respectively. This imposes a risk of under-recovery of Cost of Debt if the Utilities index credit rating improves over RIIO-2 due to the fact it does not have a defined rating.

Lack of robust financeability assessment

1.63 Ofgem have conducted an "in the round" assessment of financeability for the RIIO-2 period with the focus very much on the debt finance of a notional company and very little regard to actual company parameters or the financeability of equity. This is at odds with the analysis that companies were instructed to provide along with their Business plan submissions.[15] The impact of an "in the round" assessment on individual ratios and the importance placed on them by external parties, such as investors and credit ratings agencies should not be ignored.

1.64 Ofgem needs to reflect, the potential scale of expenditure that may be required via reopeners, through its stress testing of financeability. The output from financeability stress testing needs to demonstrate the company can maintain a comfortable investment grade rating, after funding all reopeners, to continuously comply with its licence and facilitate the raising of additional funds as required.

1.65 Furthermore, Ofgem's analysis fails to cover the financeability of the actual companies, the impacts to cash flows resulting from the RIIO-T1 close out process or how the proposed changes to annual price control mechanisms (i.e. AIP). Ofgem have also made adjustments to the assumptions around the financial structures of the notional company which have drastically improved the implied credit ratios but do not reflect the real-world characteristics of companies. An example of this is increase in the assumption of CPIH index linked debt from 25% to 30% based on an average of the network operators. The disparity between companies is wide with some companies such as SPT holding no index linked debt whereas others such as NGET hold higher levels than the average. Another example, is the adoption of the aforementioned new index for the Cost of Debt which could have a detrimental impact on the financeability of Network companies, as currently the new index does not reflect a similar credit quality of the network operators.

1.66 The arguments for providing a lower level of gearing from Ofgem was to take account of the higher level of risk involved with the delivery of the required Totex in the regulatory period. It is inconsistent not to recognise this through a higher cost of equity. It is a highly plausible scenario that shareholders in the electricity transmission sector, after consideration of the scale of reduction in cost of equity, would prefer a higher notional gearing, above the 55% reflected in the draft determination, if the WACC will remain unchanged at a higher gearing and therefore reduce its commitment equity with no impact on the WACC.

1.67 The views of Credit Rating Agencies must also be taken on board, Moody's for example have recently commented "Social risks have, however, become evident, with the regulator diverging at the margin from established practice following criticism. Ofgem's new outperformance wedge for the forthcoming RIIO-2 price controls will reduce allowed equity returns and weaken adjusted interest coverage ratios.[16]" These changes represent a departure from established regulatory practice, adherence to which has supported widespread confidence in the stability and predictability of the regime.

1.68 Pressure on metrics will be exacerbated by the impact of the COVID-19 pandemic which should not be ignored due to the longer-term impact this could have on the wider economy, notably on inflation. Ofgem's stress testing of financeability needs to reflect the cash collection risk, which Ofgem propose will be passed

[15] RIIO-2 Business Plan Guidance 9 September 2019
[16] Moody's Investor Service: Sector comment Regulated Energy Networks – UK, RIIO-2 proposals support sector's business risk profile, but legitimacy in greater focus – 3 August 2020

to the TOs in T2. Revenues of regulated energy networks and the value of their assets are directly linked to an inflation index, exposing them to the risks of low inflation. Debt also typically bears fixed rates of interest, which effectively increase in such a scenario. Prolonged low inflation would therefore lead to a relative reduction in cash flow and a weakening of a network's financial profile, a credit negative. Networks in GB are vulnerable to low inflation scenarios due to the regulatory funding model i.e. real return based on an inflation based RAV. This model leads to a "Cash flow gap" as the Nominal interest debt raised by Networks are paid down by a real return with the Inflation proportion added to RAV and paid over time. The lower the inflation, the weaker the asset base on which to borrow.

1.69 Furthermore, the inclusion of Expected v. Allowed related cash flows in the financeability assessment is flawed. This is due to the fact that there is no guarantee that the cash flows from this adjustment will be received during the period. Ofgem has proposed an ex post true up mechanism however the proposal is not company specific and would be applied on an electricity transmission sector basis therefore it is plausible that SPT could end up in a scenario where the intended return is not realised and no true up would be implemented.

Ofgem's CAPM estimations 'Cherry Pick' financial theory

1.70 Ofgem's methodology for estimating the CAPM's individual parameters contains numerous errors. Ofgem has not properly addressed the issues raised by stakeholders, in relation to their evidence base in the Consultation. For example:

i. CEPA's Dividend Growth Model, a key component of Ofgem's cross-checks, understates the expected TMR, due to implausibly low assumptions around dividend growth. It is also clear that the level of returns indicated by Ofgem's proposals do not reflect the risks faced by network companies as mentioned above.

ii. Ofgem's reliance on an alternative historic inflation series understates the expected real TMR as it overstates historical inflation. The inflation series is based on back-cast data which the ONS consider to be unreliable

1.71 Ofgem have also committed to departing from the well-understood and longstanding regulatory practice of selecting the upper end of a cost of equity range. This has been supported in a number of ways, including academic research, which has found that aiming up, well above the central estimate, is likely to minimise the expected losses to society from underestimating the regulated business's true cost of capital.

1.72 In relation to Ofgem's proposal to introduce an "Allowed v Expected" adjustment to the CAPM Cost of Equity parameters, we consider that this is an arbitrary adjustment, which must be removed from Ofgem's Cost of Equity proposals. Historic outperformance cannot be a guide to future outperformance within a newly calibrated and significantly modified (and highly asymmetrical) incentive regime. This proposal goes against the past stability and predictability of the WACC-setting process, which is fundamental in the UK regulatory model and has aimed to maintain investor confidence. It is also clear that Ofgem has clearly departed from the existing incentives regime, so historic performance will most certainly not be reflective of the future performance in RIIO-2. In addition, we believe the data which its behind Ofgem's adjustment is incorrect.

1.73 Ofgem's proposals undermine the stability and predictability of the WACC-setting process, which is fundamental to the UK regulatory model. This undermines investor trust and confidence.

1.74 A further Ofgem error is that Ofgem repeatedly gives insufficient weight to cogent evidence that points to a higher cost of equity whilst giving undue weight to less cogent evidence that points to a lower cost of equity. As an example, Ofgem give excessive weight to evidence about OFTO IRRs, and investor forecasts. In adopting this approach Ofgem falls into error. We would also highlight that Ofgem has not been able to share the relied upon OFTO evidence with companies as it has advised this data is confidential.

Ofgem's competition models introduce further uncertainty for investors and have not yet demonstrated benefit to consumers

1.75 We continue to support the role of competition in electricity transmission, but only where it can clearly demonstrate benefits and value for consumers. Ofgem's proposed competition models have not yet demonstrated consumer value.

1.76 We are actively involved in the ESO's development of its Early Competition Plan. The 'early' CATO model is the only competition model proposed by Ofgem which could potentially deliver actual competition. The 'late' CATO model whereby the TO would be responsible for design, planning and consenting of the project adds little or no value to consumers and will contribute to delays in the delivery of major infrastructure, as a result of planning, tendering and other process issues, resulting in material costs to consumers and increased greenhouse gas emissions.

1.77 Both 'early' and 'late' CATO models require primary legislation to implement. Ofgem must act within the current legal framework in extending competition in electricity transmission. Ofgem's proposals constitute material changes and, as such, Ofgem should wait until Parliament has scrutinised any reforms and passed the required legislation.

1.78 Due to the lack of Parliamentary time, Ofgem has proposed two other models which it states do not require legislation. The first model, the "Special Purpose Vehicle" or "SPV" is unlawful, as we have explained in various submissions.[17] The second model, the "Competition Proxy Model" or "CPM" is materially flawed.[18] Ofgem's own recent assessments of the application of CPM to the Hinkley-Seabank and Shetland Projects demonstrate no benefit to present and future consumers.[19] Both models are materially under-developed. They should not be introduced as part of RIIO-T2. This is clearly a significant area of unknown policy and introduces further uncertainty for our investors given the scale of investment associated with the relevant projects which could be tendered.

Ofgem's process

1.79 Whilst we recognise COVID-19 will have impacted Ofgem, RIIO-T2 has been characterised by significant procedural difficulties and flaws. We have however observed this through the development of the Business Plan guidance as well as the Draft Determination.

A lack of clear and timely guidance on the assessment of the Business Plan

1.80 Before we submitted our Business Plan, Ofgem confirmed the critical role of the User Group and Challenge Group. These were to be a key element of Ofgem's assessment of Business Plans. However, the terms of the Draft Determination suggest that the reports issued by the User Group and Challenge Group have been discounted. Indeed, Ofgem seldom mentions the work of the Groups in the Draft Determination.

1.81 We have serious reservations about various aspects of Ofgem's conduct of RIIO-T2. Ofgem's guidance for preparation of the Business Plans was finalised just over a month before the plans were due to be submitted. There has been no meaningful consultation on the cost assessment process, which is materially flawed and is detailed in our response to the totex adjustments.

[17] See for example "Extending competition in electricity transmission: commercial and regulatory framework for the SPV Model Consultation" SPEN, 9 November 2018. Available here.
[18] See for example SPT's response to Ofgem's 2018 consultation on Hinkley-Seabank (March 2018); SPT's response to Ofgem's consultation on extending competition in electricity transmission (November 2018); and SPT's response to Ofgem's updated minded-to position for Hinkley-Seabank delivery model (November 2019).
[19] "Hinkley - Seabank: Updated decision on delivery model", Ofgem, 22 May 2020. Available here. "Shetland transmission project: Decision on Final Needs Case and Delivery Model", Ofgem, 30 July 2020. Available here.

1.82 Our Business Plan had to comply with Ofgem's Business Plan Guidance (**BPG**). The first draft BPG was published on 21 December 2018. Updated versions were published on 3 June 2019 (less than one month before companies had to submit first drafts of their Business Plans to the Groups) and 9 September 2019 (less than one month before companies had to submit their second drafts to the User Group and Challenge Groups). The final version of the BPG was not published until 31 October 2019, just over one month before the final submission date for the plans and after the companies had already submitted two versions of their plans to the User Group and Challenge Groups.

1.83 Material elements of Ofgem guidance were provided very late in the process. For example, Ofgem's expectations on CVP proposals were not set out until the September version of the BPG. Ofgem also published other key documents very late in the process, including the final Business Plan Data Templates in September 2019.

Draft Determination assessment

1.84 Ofgem justifies the rejection of our proposals on the basis that SPT did not provide sufficient evidence. We submitted our Business Plan following a high-quality assurance process, and thorough scrutiny by the User Group and the Challenge Group. In the run up to the Draft Determination senior Ofgem personnel assured us that our plan was well justified. On this basis alone, we find the rejection of our proposals surprising.

1.85 After we submitted our Business Plan Ofgem had ample opportunity to ask us for further information. However, there are many examples where Ofgem has rejected our proposals without having raised questions through the supplementary question process. To address this issue as best we can, and in advance of this consultation response, we have provided Ofgem with 22 updated or additional justification papers and accompanying evidence.

1.86 Ofgem has rejected a wide range of our proposals without providing clear reasons. In some cases, no reasons are provided.

Transparency during the Draft Determination Consultation

1.87 Ofgem published the Draft Determination on 9 July 2020 with a deadline for response was 8 weeks later, on 4 September 2020. The Draft Determination cannot be fully understood without access to various Ofgem models. These were only made fully available by Ofgem on 24 July 2020, two weeks after the publication of the main document. SPT has asked Ofgem a range of questions about the Draft Determination since 9 July 2020 with many of these responses not being received until two weeks before the deadline for submission.[20]

1.88 Against that background we will continue to review the Draft Determination after 4 September 2020 and reserve the right to make further submissions to Ofgem on any other areas of concern we identify. It is of paramount importance that SPT and the other network companies have sufficient time and opportunity to ventilate – and that Ofgem listens to - issues that we identify in this response and subsequently in the Draft Determination prior to Ofgem's Final Determinations being published.

[20] We also note that, after the publication of the DD Core Document, Ofgem added an additional question (Q17) "*What are your views on including the delivery of outputs such as: CAF outcome improvement; risk reduction; and cyber maturity improvement, along with projects-specific outputs*?" Ofgem did not communicate to SPT that such a question had been added to the consultation.

Licence drafting being developed in advance of policy being determined

1.89 In parallel to the Draft Determination process, the licence drafting for RIIO-2 is ongoing. However, until further clarity and analysis has been provided on the various price control instruments, such as the Licence, Financial Handbook and Price Control Financial Model (PCFM), a full understanding of the wider impacts cannot be achieved. In addition, we have been advised by Ofgem that there will be a 4 week consultation period to consult on the full T2 draft licence next month. Such timescales will not provide licensees with sufficient time to review these conditions in full so as to undertake the required analysis and due governance.

Conclusion

1.90 We have serious concerns over the proposals set out in the Draft Determination.

i. The totex adjustments contain material errors that require to be addressed and inconsistencies which impact our plans. Material evidence we have provided has been disregarded or overlooked.

ii. Ofgem's proposed ongoing efficiency stretch is not supported by evidence and is a "double count" of SPT's embedded efficiencies.

iii. The Business Plan Incentive is flawed and relies on an arbitrary adjustment. It is not reflective of stakeholder views of our Business Plan.

iv. Uncertainty Mechanisms and incentives (ODIs) fail to provide adequate protection to TOs and do not create an attractive package which will ultimately hinder the UK's ambitions for Net Zero.

v. Ofgem's proposed finance package does not reflect the increased level of risk that TOs are exposed to, benchmarks poorly with other comparators and includes unjustified adjustments.

vi. The process followed by Ofgem has had serious failings which has compromised our ability to respond to the Draft Determination and lacked transparency.

1.91 The Draft Determination ignores the views of stakeholders, and more specifically the User Group and the Ofgem Challenge Group.

1.92 Without a Final Determination addressing the points identified in this response, we will not be able to deliver our Business Plan and we will have no option other than to revisit the scope of projects and operational activities we have set out in our plan. Nevertheless, given the depth of the cuts to our expenditure allowances proposed by Ofgem, we have started the process of identifying the consequential adjustments that would enable us to meet Ofgem's requirements. This leads to the inevitable conclusion that complying with the Draft Determination will produce consequences that Ofgem previously sought to avoid. The Draft Determination contains an implicit, material and un-signalled change in Ofgem's approach to key issues. Some examples are as follows:

i. **Jobs -** In the Sector Specific Methodology Decision Ofgem said, "Resilience also depends on companies having sufficient people with the required skills needed to design, build, operate, maintain and repair their networks." We agree. We believe it is critical to enhance workforce resilience in the RIIO-T2 period. This has become even more essential in light of the UK's current economic downturn caused by COVID-19. For example, our plans include the recruitment of graduate trainees and apprentices. However, in the short run such recruitment is not absolutely necessary. Accordingly, we are now forced to review these plans.

ii. **Net Zero -** In the Sector Specific Methodology Decision Ofgem said: "7.3 Alongside these responsibilities, the gas and electricity networks also need to mitigate their environmental impact through their own business activities. In our Business Plan we proposed a range of measures to reduce the carbon footprint of our business. Ofgem's signals in the Draft Determination are that these measures are not necessary in the short run. We are therefore having to carefully review whether we can progress these initiatives in light of the proposed cuts to our expenditure required by Ofgem.

iii. **Outputs -** 96% of our expenditure is competitively tendered therefore the option to reduce costs without re-scoping activity is very limited, noting that despite the cost reductions applied, Ofgem's engineers have agreed the scope on all but a handful of our projects. We have analysed the reductions and the bearing that these would have on our Business Plan. If these are to continue at Final Determination, we will have no option other than to revisit the scope of projects and operational activities we have set out in our plan.

1.93 More generally we cannot reconcile the Draft Determination with the wider objectives of a "Green Recovery". Expenditure proposals that are manifestly required to achieve Net Zero have been rejected. These are proposals that could strongly support a Green Recovery on a low or no regrets basis. This is also at odds with the long-term approach taken by other sectors, for example Ofwat were one of the signatories on an open letter which pledged that "Government and water regulators will facilitate water companies to accelerate planned investment, bring forward future investment and implement new ideas to boost the economy". Ofgem's approach is out of line with this policy objective.

1.94 Our industry must be utilised as a catalyst for supporting businesses indirectly and job creation in addition to directly keeping our communities in employment. However, Ofgem's Draft Determination does not provide adequate signals to investors to commit to the UK and create this stimulus.

1.95 Ultimately, the Draft Determination is manifestly flawed and if implemented, we have been advised that it is clearly appealable to the CMA. However, an appeal is not inevitable, and our preference would be to work constructively with Ofgem in order to resolve these differences, thereby avoiding the need for an appeal, and, at a minimum ensure that we have worked together to properly narrow and focus the areas of dispute.

1.96 We have provided a comprehensive response to the Draft Determination Consultation which we trust provides a constructive perspective, along with additional evidence to support our arguments. Throughout the development of our RIIO-T2 Business Plan we have sought to work constructively with Ofgem and are committed to do so in the months ahead as the Final Determination is prepared.