SSEN Distribution

DRAFT DETERMINATION RESPONSE

August 2022

Scottish & Southern Electricity Networks

INTRODUCTION

Ofgem will be reaching a final decision on the RIIO-ED2 price control later this year, amidst concurrent crises: climate; energy; and cost of living. This is not the time for short-term decision-making, and Ofgem has the opportunity now to drive the efficient investment in energy systems required to enhance security of supply in a more volatile geopolitical environment. This will (i) set the country up to decarbonise quickly; (ii) increase network resilience, giving consumers the confidence to switch to low-carbon technologies, and ultimately (iii) keep costs low in the longer-term. This will mean all our customers can benefit from a just transition, including the most vulnerable.

Against this backdrop, it becomes even more critical that in its decision-making for RIIO-ED2, and in line with its principal objective, Ofgem appropriately weighs the interests of current and future consumers in the delivery of a secure electricity supply and in reducing electricity-supply emissions of targeted greenhouse gases; in addition to ensuring that all licence holders are able to finance their activities.

Ofgem's Draft Determination (DD) would not sufficiently fund SSEN to deliver an efficient, sustainable and just transition to net zero, and over 50% of the outputs we co-created with our customers and stakeholders would be undeliverable or at risk. This insufficient funding is the result of a number of significant methodological and factual errors.

Our original business plan,[1] co-created with stakeholders, set out evidence-led proposals for achieving key policy objectives, without an increase in consumer bills. Conversely, Ofgem's DD will materially impact current and future consumers by imperilling the security of our energy system and compromising the country's ability to meet net zero targets.

Unless errors and inconsistencies are addressed in Final Determination (FD), SSEN will not be able to efficiently deliver the network and outputs that all stakeholders and customers, current and future, expect and deserve. Ofgem's DD would increase costs for all in the longer-term, delaying connections by up to two years, limiting our ability to drive efficiencies through our supply chain, and reducing planned improvements in system reliability even as we all become more reliant on electricity.

1. **Network investment is required now to decarbonise efficiently and prevent an increasing infrastructure gap that cannot keep pace with growing demand: by resolving a number of material errors in its DDs Ofgem can enable sufficient funding to support the net zero transition.**
   - Ofgem's decision to remove all strategic investment, revert to System Transformation,[2] and make other cuts, for example through a top-down demand driver adjustment, puts out of reach the possibility of achieving net zero at the lowest cost to energy consumers including through the deployment of flexibility. Failing to make investments now only increases the overall cost of net zero, and also unfairly pushes a high proportion of these costs of decarbonisation onto future consumers, inconsistent with Ofgem's principal objective.[3]
   - This DD is also contrary to business planning guidance and wider expectations set by Ofgem. For example, it forecloses our ability to meet our industry-leading and stakeholder-supported 1.5°C Science Based Target (SBT). It is also inconsistent with the detailed customer and stakeholder engagement mandated by Ofgem and assessments of future growth detailed in the ESO's latest Future Energy Scenarios, published in July 2022.[4] It fundamentally does not respond to the strong and consistent feedback from stakeholders for more ambitious goals and a greater level of investment.
2. **Ofgem has set an unachievable and unreasonable efficiency target for all DNOs, exceeding any previous regulatory determination for a UK regulated company. This reduces our ability to drive efficiency by optimising across a known programme of work.**
   - Ofgem has chosen a 1.2% yearly efficiency challenge for all DNOs, which is higher than it has ever used before, not consistent with general productivity movements particularly coming out of Covid, and is not supported by the expert technical evidence, even from Ofgem's own consultants.
   - Ofgem has set an unreasonably onerous target for catch-up efficiency across DNOs, which is flawed in itself and fails to account for the specific characteristics of SSEN's network in the north of Scotland (see below).
   - Ofgem has not considered that DNOs will need to make step-change increases in their delivery programs in a contested, rapidly growing sector, and a volatile inflationary environment. In particular, its real price effects (RPEs) methodology is materially wrong, and will not enable DNOs to recover efficient costs.
   - As a result, a number of unit rates allowed for certain asset categories are not reflective of actual costs and are undeliverable, putting at risk the overall delivery of our stakeholder-led outputs. Ofgem has compounded this by shifting additional costs into uncertainty mechanisms (UMs) and reducing the cost of equity. This reduces our ability to drive efficiency by optimising across a known programme of work.
3. **The north of Scotland has a central role to play in decarbonisation. Through allowing dedicated investment in our network Ofgem can enable the connection of more renewable generation and a reliable electricity supply for remote communities.**
   - Scotland has set a legally binding 2045 net zero target, five years ahead of the rest of the UK, underlining the need for greater electrification. Greater investment is required in both network capacity and reliability to facilitate decarbonisation, and support an ever-increasing reliance on the electricity network.

[1] *www.ssenfuture.co.uk/wp-content/uploads/2021/12/24645-SSEN-ED2-Final-Business-Plan-Website.pdf*
[2] *System Transformation is the lowest net zero compliant scenario in the FES 2020*
[3] *www.theccc.org.uk/wp-content/uploads/2019/05/CCC-Accelerated-Electrification-Vivid-Economics-Imperial.pdf*
[4] *www.nationalgrideso.com/future-energy/future-energy-scenarios*

- Ofgem's DD fails to recognise SSEN's clear shift towards a strategic whole system approach to managing our fleet of subsea cables, founded on clear stakeholder feedback. This is based on a mix of proactive and responsive replacement to underpin resilience for both increasing demand and generation needs, and reduce reliance on carbon-intensive standby generation. It also runs contrary to previous acknowledgement from Ofgem that a more strategic approach was required compared to RIIO-ED1.
- Ofgem's benchmarking process must acknowledge the specific additional costs associated with operating in the north of Scotland due to its unique geography. It is critical that Ofgem gives appropriate consideration to the evidence provided by SSEN, for example in relation to the significant costs of maintaining the electricity network in geographically remote, large and sparsely populated regions.

4. **Ofgem must strike a fair balance between baseline spend and UMs to be shared equitably between customers and companies. Its current proposals do not strike the right balance, and are not in the long-term interest of customers.**
   - Ofgem's overuse of UMs in a number of areas including strategic investment, PCBs and cybersecurity, hampers our ability to drive efficiencies through a certain, well-planned programme of work. The result is a small benefit to current consumers in terms of bill reduction to the significant detriment of future consumers.
   - At the same time, Ofgem's proposal to reject three of our bespoke UMs relating to wayleaves and diversion, ash dieback, and subsea cable faults, fails to recognise that these risks sit clearly outside of managements control. This is a divergence from Ofgem's policy intent to de-risk RIIO-ED2.
   - The proposed RIIO-ED2 capitalisation rate for UMs follows neither the natural split nor the regulatory precedent set by RIIO-ED2/T2. An appropriate capitalisation rate supports equity financing during high investment periods such as RIIO-ED2.
5. **In the last 12 months we have experienced seven named storms and record-breaking temperatures, with forecasters warning of extreme events becoming more frequent. This emphasises the increasing importance of investing in network resilience in a changing climate, and as society becomes more dependent on electricity.**
   - Ofgem is proposing to reduce our £1bn investment in strategic resilience by 29%, at a time when SSEN is working collaboratively to implement the recommendations of the Storm Arwen report, and this summer has seen the highest ever temperature recorded in the UK.
   - Ofgem's benchmarking process and DD result in outcomes that are clearly not in the interests of customers: for example it would take us between 600-1,000 years to replace cables that were laid in the 1960s. Preventing SSEN from replacing key assets at the end of their lives will likely result in significant increased risk of disruption to power supplies. This also does not align with stakeholder demands that DNOs facilitate net zero in a safe, reliable, and resilient way.
   - Our investment programme is designed to deliver continued high levels of reliability in a changing world: Ofgem must either rethink its approach or accept that its refusal to fund the investment in resilience that customers need will result in a lower standard of service for consumers in southern England and the north of Scotland.
6. **Ofgem's DD results in downward pressure on financeability over RIIO-ED2, materially below the requirements for a strong investment grade credit rating. This will put investment at risk, to the detriment of current and future consumers.**
   - The Cost of Equity (CoE) at FDs needs to reflect market evidence, and new evidence pertaining to sector-specific risks. Ofgem must review its approach to determining CoE parameters, including the risk-free rate, beta and total market returns.
   - The cost of debt allowance must be updated to reflect increasing interest rates and plausible high interest rate scenarios over RIIO-ED2. Otherwise, notional DNOs will be underfunded over RIIO-ED2 simply based on market expectations of future interest rates.
   - Ofgem should not break from their long-term policy commitment on the treatment of inflation. Ofgem have not presented any evidence, analysis or impact assessment of why the treatment of inflation is incorrect or should change. This undermines regulatory certainty and investor confidence, while also adding upward pressure on sector risks and the cost of capital to the detriment of investors and consumers.
7. **Ofgem's process has lacked transparency and clarity throughout.**
   - Ofgem's Business Plan Guidance has failed to drive consistency across DNOs, in a number of areas, including scenario planning, vulnerability, DSO, and Environmental Action Plans. This has made it difficult to compare plans and highlight best practice, and has resulted in a number of unjustified reductions in costs.
   - Key policy decisions around framework and incentive design have yet to be made and have been further compounded by the descoping of key milestones, for example around the Access Significant Code Review (SCR). Ofgem's approach to assessing business plans includes numerous errors, which have been compounded by a lack of transparency in the process, with key information only provided at an unreasonably late stage in the process. This has limited our ability to engage in the consultation process.

Through RIIO-ED2, SSEN and the other GB DNOs have carried out the most extensive programme of stakeholder engagement ever undertaken for an economic price control in the energy sector. We have continued to engage with key stakeholders throughout the consultation process. Our comprehensive response to Ofgem's DD builds on this engagement and is targeted at improving Ofgem's understanding of SSEN's plan. Where relevant, we outline errors in the DD and our proposed resolution, and provide additional evidence in support of our position.

The UK and Scottish governments have clearly signalled that the best way out of the current energy and cost of living crises is to decarbonise our energy system and move away from costly and carbon-intensive fossil fuels. With strong stakeholder support, Ofgem now has an opportunity to play its part. It is clear that it cannot afford to wait until after April 2028. We look forward to maintaining an open dialogue with Ofgem and stakeholders in the run up to FDs to ensure RIIO-ED2 delivers optimal policy outcomes for our customers and society.

EXECUTIVE SUMMARY

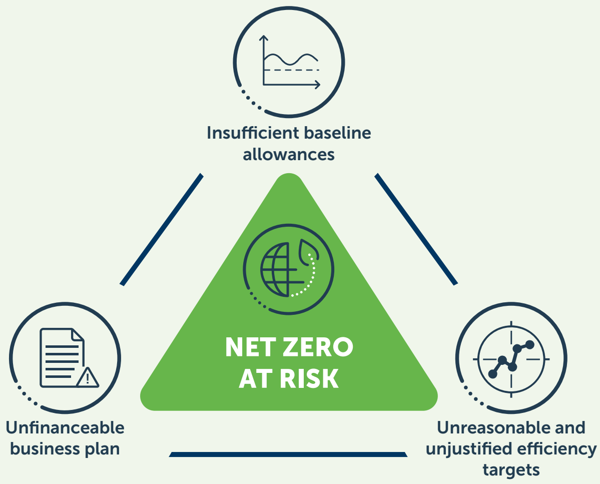
Getting RIIO-ED2 right is critical to successfully moving away from our reliance on fossil fuels. Only by accelerating net zero now can we create an energy system that is sustainable, low cost, and enables a just transition for current and future consumers. SSEN is concerned that Ofgem's Draft Determination (DD) contains a number of significant and factual errors and inconsistencies, and as a result will not efficiently deliver net zero policy objectives. In order to meet customer, stakeholder, government and its own stated objectives, Ofgem needs to recalibrate its thinking as it works towards its Final Determination (FD).

We welcome Ofgem's recognition of the quality of DNO plans across the board, with all DNOs meeting Stage 1 minimum requirements. We are proud of being the only DNO to potentially receive rewards for two of our Customer Value Propositions (CVP), with a third proposal also receiving funding. These proposals were strongly supported by our stakeholders, are truly innovative, and will deliver genuine value for our customers and their communities.

However, Ofgem's approach in a number of key areas in its DD clearly fails to adequately allow for the delivery of its policy objectives and puts these at risk. This document summarises the key errors and issues we have identified in Ofgem's Draft Determination which should be fully considered and then corrected at Final Determination.

To enable us to (i) deliver a secure and sustainable electricity supply for our customers and stakeholders, and (ii) invest sufficiently in an efficient transition to net zero, Ofgem must ensure that its Final Determination (FD):

- Includes sufficient baseline allowances to enable SSEN to meet customer expectations and obligations, and work closely with our supply chain to proactively address deliverability challenges
- Is based on reasonable and justified efficiency targets
- Is financeable and does not unreasonably expose us to material risks outside of our control.



Ofgem's Draft Determination is inappropriately calibrated and does not strike the right balance across all key components of the price control - clearly putting policy outcomes at risk.

This is in line with the feedback we have received from a wide range of the stakeholders we engaged with throughout the DD consultation process, who have expressed particular concerns that Ofgem's approach will act as a blocker to a credible net zero pathway and reduce our ability to ensure network resilience in the face of climate change. Our supply chain partners have further reinforced the need to ensure we are able to plan ahead to secure and develop resources at a more efficient cost for our customers and enhance deliverability.

While Ofgem issued its DD on 29 June, further information has been made available over the last two months, with key clarifications and corrections being issued in the last few weeks of the DD consultation. Given these process failings, we reserve the right to raise further points into autumn.

With the UK facing climate, energy and cost of living crises, in parallel with war in Ukraine RIIO-ED2 is not a regular price control. In that context Ofgem's Draft Determination puts policy objectives and stakeholder ambitions in jeopardy.

1 The climate emergency, cost of living crisis and increasingly unstable geopolitical situation mean that RIIO-ED2 is unlike any other price control we have seen before. It is critical that in discharging its duties Ofgem gives appropriate regard to the wider challenges society is facing and recognises that these unique challenges require a change in mindset and approach.

2 The UK and Scottish governments have set legally binding targets for net zero by 2050 and 2045 respectively. In addition, the UK Government's Net Zero Strategy[5] set an accelerated target to decarbonise the electricity sector by 2035, and align pathways to the Sixth Carbon Budget. The Climate Change Committee (CCC) has set out its view that electricity demand will more than double by 2050[6]. Finally, 87% of our 72 local authorities have declared a climate emergency, setting ambitious local strategies and targets. Ofgem's DD would mean we could not enable the activity needed to meet these targets.

[5] *www.gov.uk/government/publications/net-zero-strategy*
[6] *www.theccc.org.uk/wp-content/uploads/2020/12/Sector-summary-Electricity-generation.pdf*

SSEN is concerned that the DD fails to properly have regard or to give the appropriate weight to the interests of current and future consumers in the delivery of a secure electricity supply and in reducing electricity-supply emissions of targeted greenhouse gases. The effect is to endanger net zero ambitions across our communities, and the reduced level of investment possible under the DDs will not allow SSEN to meet its 1.5°C target. This will create delays in our ability to connect our customers and deliver net zero.

- Ofgem's proposed cuts of £31m to our Environmental Action Plan (EAP) directly undermine our ability to meet our industry-leading and stakeholder-supported 1.5°C Science Based Target (SBT), also a requirement under Ofgem's business plan guidance.
- Ofgem has taken the explicit decision to remove all strategic investment from our baseline plan, worth £23m. This is despite strong stakeholder support for such investment, and in contradiction to its own business plan guidance.
- The top-down modelling adjustments applied in the DD in an attempt to enable comparison across DNOs are erroneously applied, and neither accurately reflect our business plan submission, nor the specificities of our SHEPD network. This results in unjustified cuts worth £84m.
- **We welcome Ofgem's proposal to accept our ambitious Life Below Water CVP. We consider that this CVP is industry-leading and will deliver significant longer-term value to our communities.**
- **We welcome Ofgem's proposal for a volume-driver and acknowledgment that uncertainty mechanisms must be agile, Further work is required on the design of the volume-driver to ensure unit costs are properly reflective of the costs faced by each company and the use of flexibility solutions is incentivised.**

The table below illustrates the impact Ofgem's Draft Determination would have on priority net zero outputs we co-created with our stakeholders.

ACCELERATING PROGRESS TOWARDS A NET ZERO WORLD

OUTPUT AREA	FINAL BUSINESS PLAN STAKEHOLDER - LED OUTPUTS	REFORECAST OUTPUTS BASED ON OFGEM'S DRAFT DETERMINATION
Load-related Investment	Ready the network for net zero, consistent with up to 1.3m Electric Vehicles and up to 800,000 heat pumps connecting by 2028	Ofgem's Draft Determination would mean major reductions in our load-related expenditure proposals. **This would lead to a 30% shortfall in the number of Low Carbon Technologies (LCTs) supported over the ED2 period – including 10,000 fewer EV charge points per year.** This would mean our baseline plan is not compliant with the lowest net zero scenario, System Transformation. Ultimately, Draft Determination cuts to strategic investment could mean delays of up to 2 years for LCT connections.
Load-related Investment	Ready the network for net zero, consistent with a total of 8GW of distributed energy resource (including windfarms, solar, and energy storage) connecting by 2028	Ofgem's Draft Determination would result in **800MW of DG capacity (including PV, wind, and storage), below the lowest net-zero compliant DFES scenario.** Ofgem's Draft Determination cuts to strategic investment could mean **delays of up to 2 years** for LCT connections.
Small/Minor Connections	Improve the end-to-end process (application, design, quote and connection) for all our connections and introduce automated quotation services for domestic LCT and minor connections customers by 2025	Ofgem's Draft Determination would reduce our ability to process high volumes of LCT connections leading to a **slower, more manual process for our customers** and contributing to delays outlined above.
Business Carbon Footprint	Set an ambitious 1.5°C SBT (including losses) requiring at least a 35% reduction in our carbon footprint by 2028	Ofgem's proposed Draft Determination cuts foreclose ability meeting our **industry-leading and stakeholder-supported 1.5°C Science Based Target (SBT).**

3 The recently published Electricity Networks Strategic Framework[7] from Ofgem and BEIS recognises the significant changes our electricity networks are undergoing and also the need for a more strategic approach to managing networks. **RIIO-ED2 must enable the investment in new and traditional technologies required to meet net zero.**

4 Other recent publications surrounding the Pathway to 2030 and Holistic Network Design (HND)[8] at transmission level are reflective of a more strategic approach to investment planning and delivering net zero. Indeed, Ofgem is currently consulting on how it can "support the accelerated delivery of strategic electricity transmission network upgrades,"[9] in stark contrast with a RIIO-ED2 framework which is not fit for purpose. We urge Ofgem to ensure that a similar mindset is reflected in RIIO-ED2 now, rather than require a significant change in approach at a later date.

[7] *www.gov.uk/government/publications/electricity-networks-strategic-framework*
[8] *www.ofgem.gov.uk/publications/minded-decision-and-further-consultation-pathway-2030*
[9] *www.ofgem.gov.uk/publications/consultation-accelerating-onshore-electricity-transmission-investment*

5 The effects of climate change are already being felt, including on our networks. During winter 2021-22, we were the only DNO to be affected by seven named storms, and this summer has seen record-breaking temperatures across the country. We are proud of our response to these events. At the same time, we recognise that customer reliance on electricity will only grow. **A wider conversation in the wake of Storm Arwen and other extreme events is urgently required at industry level, and with our customers and stakeholders, to understand how best to meet changing expectations.**

Ofgem has cut 29% from the £1bn programme of work for strategic resilience we proposed in our plan. This would limit our ability to mitigate the impact of the climate crisis on our network and communities, and mean we would need to deprioritise stakeholder-driven outputs to ensure we meet legal obligations.

- In applying these cuts, Ofgem has departed from its previously stated methodology and industry best practice, making selective use of outdated methodologies.
- Ofgem's approach results in outcomes that are clearly not in the interest of either current or future customers: for example, our low voltage underground network will be critical to delivering net zero, but the level of investment possible under Ofgem's DD would mean it would take us between 600-1,000 years to replace cables that were laid in the 1960s and are reaching their 'end-of-life' stage.
- The funding provided under the DD would not enable us to deliver for our customers in the SHEPD region. Ofgem fails to acknowledge the additional £223m costs associated with managing the most remote network in the country, and this will constrain our ability to invest strategically in 15 subsea cables, despite strong stakeholder support and steers from Ofgem to this effect.
- **We welcome Ofgem's change in approach to the Interruptions Incentive Scheme (IIS), which we think will deliver better value by incentivising improvements in performance that are in the consumer interest. However, Ofgem's approach will have an impact on our ability to meet our more ambitious target of a 20% reduction in the number and duration of power cuts, co-created with our stakeholders.**

The table below illustrates the impact Ofgem's Draft Determination would have on priority safety and resilience outputs we co-created with our stakeholders.

DELIVERING A SAFE, RESILIENT AND RESPONSIVE NETWORK

OUTPUT AREA	FINAL BUSINESS PLAN STAKEHOLDER - LED OUTPUTS	REFORECAST OUTPUTS BASED ON OFGEM'S DRAFT DETERMINATION
Safety	Continue to meet all safety-related legal requirements	Ofgem's Draft Determination fails to recognise the necessary expenditure required to **meet our legal obligations**, therefore we would need to re-**route funding away from other stakeholder-led outputs.**
Network asset risk	Intervene in our network assets with the highest probability of failure, reducing longer-term risk by just over 14%, relative to a future without intervention	Ofgem's Draft Determination would result in **a more than 20% increase in risk of failure on our network** compared to our final Business Plan, this is because we are not able to replace our ageing assets and make our network more resilient to climate change.
Interruptions Incentive scheme (IIS)	Meet our targets and reduce the average frequency and duration of unplanned power interruptions affecting our customers by 20% by 2028	Ofgem's Draft Determination would mean that our targeted improvements to reduce the frequency and duration of unplanned interruptions **would be reduced by up to 50%.**
Scottish islands	Replacement or augmentation of 13[10] subsea cables with the greatest needs case	Ofgem's Draft Determination would reduce our Business Plan to **only replace or augment seven subsea cables,** this would **reduce our planned network resilience improvements by £30m,** impacting customers in Orkney, Uist and the Inner Hebrides. This would also inhibit the connection of renewable generation and the provision of flexibility services on these islands, and these communities would continue to rely on back up diesel generation.
Scottish islands	Three new cables between Skye and Uist, and Pentland Firth West to Orkney	Ofgem's Draft Determination would **remove these cables from our Business Plan,** which means these communities would continue to rely on back up diesel generation. As above this would also inhibit the connection of renewable generation and the provision of flexibility services on these islands as well as increase green house gas emissions.
Scottish islands	Maintaining and operating standby generation for island communities at our seven island-based power stations	Ofgem's Draft Determination would reduce our funding to maintain and operate standby generation for island communities, which means we **would increase reliance on our back-up diesel generation.**

[10] *Based on April 2022 resubmission*

6 We act as a unique and central touchpoint for over 3.8m customers, and we have more than 770,000 customers on our Priority Services Register (PSR). **In the aftermath of the COVID-19 pandemic, and due to the cost of living crisis, we expect many more customers to join our Priority Services Register (PSR), and we expect to provide dedicated support to at least 1.3m customers through our plan. We must find new ways of supporting those who need it the most.**

7 At the same time, customer expectations are constantly evolving. The RIIO-ED2 framework **must enable us to meet stakeholder needs, including through the digitalisation of our network and services.** The Draft Determination fails to do this, potentially increasing long-term costs for consumers.

A 26% reduction in funding for key digitalisation-enabling activities will reduce the services we are able to provide across our plan, including to those in vulnerable circumstances and customers seeking to connect to our network

- By applying top-down cuts of 30% to our Information Technology (IT) and Operational Technology (OT) spend, Ofgem is directly putting at risk 19 of our 64 stakeholder-led outputs. This includes for example, introducing self-serve connections processes, promoting flexibility, and supporting an "open by default" approach to providing better insights and a personalised experience.
- Ofgem's approach to assessing digitalisation costs does not recognise the significant step change required in RIIO-ED2, nor does it reflect the new obligations and reporting requirements being introduced in the DD.
- In setting its DD, Ofgem has failed to consider the significant impact its proposed cuts are likely to have on our ability to meet even tighter targets under asymmetric incentives, including those across customer service and connections.
- **We welcome Ofgem's proposed approval of the battery component of our vulnerability CVP. We think our Personal Resilience Plans would deliver significant additional value and do not see evidence that similar products are being delivered as part of business as usual.**

The table below illustrates the impact Ofgem's Draft Determination proposals would have on the customer and vulnerability outputs we co-created with our stakeholders.

PROVIDING A VALUED AND TRUSTED SERVICE FOR CUSTOMERS AND COMMUNITIES

OUTPUT AREA	FINAL BUSINESS PLAN STAKEHOLDER - LED OUTPUTS	REFORECAST OUTPUTS BASED ON OFGEM'S DRAFT DETERMINATION
Major connections strategy	Deliver high quality to service to our major connections customers achieving a customer satisfaction of 9/10 or above by the end of RIIO-ED2.	Ofgem's Draft Determination cuts to IT and digital allowances would mean major connections customers would have fewer tailored solutions and enhanced communications, **impacting on our ability to meet our stakeholder-led target.**
Vulnerability strategy	Proactively provide PSR customers with Personal Resilience Plans (PRP) containing specific advice tailored to a customer's individual needs, helping them know what to do during power cuts	Ofgem's Draft Determination **does not recognise the additional value to be provided to over 420,000 customers** through our PRPs.

ACCELERATING PROGRESS TOWARDS A NET ZERO WORLD

OUTPUT AREA	FINAL BUSINESS PLAN STAKEHOLDER - LED OUTPUTS	REFORECAST OUTPUTS BASED ON OFGEM'S DRAFT DETERMINATION
DSO strategy	Define and deliver a DSO strategy and action plan	Ofgem's Draft Determination cuts to IT and Closely Associated Indirects (CAI) allowances put the delivery of our flexible connections benefits, and benefits from using flexibility more widely to defer load-related reinforcement and manage outages at risk. **This will impact our ability to deploy new solutions to connect customers.**

8 The war in Ukraine and rising geopolitical uncertainties will continue to exacerbate the challenges we face. With significant increases in investment to deliver net zero across Europe and beyond, we are experiencing unprecedented pressures on materials, resources and workforce like never before. Covid is also still having an impact, for example on factory outputs in China and other Asian countries.

9 Within this wider context, the British Energy Security Strategy[11] recognises the critical role networks have to play. **Ofgem must create a stable and attractive environment for investors.**

10 Ofgem must be transparent in how it has reached its decisions, and must both recognise and articulate the longer-term impacts of prioritising a short-term perceived reduction in bills over efficient and economic investment that balances the interest of customers today and tomorrow.

11 **Our business plan carefully took account of affordability considerations, with our portion of the bill remaining broadly flat, even accounting for UM.** Ofgem's DD would result in a short-term bill reduction in RIIO-ED2, but would lead to significantly higher costs in future price controls.

12 **Ofgem must recognise that the investments in our plan are necessary to enable GB to move away from high-cost carbon-intensive energy sources for heating and transport, and towards lower-cost and sustainable sources of energy.**

Ofgem's DD means our business plan is currently unfinanceable. The investment possible under the DD will not enable SSEN to achieve net zero and will result in suboptimal outcomes for current and future customers.

- Ofgem has significantly departed from the approach taken at RIIO-ED1 to assess costs, without a clear explanation of its reasoning, and has made a number of material errors that must be rectified.
- Ofgem's selective use of evidence on ongoing efficiency is a material error and results in an unjustified and unachievable rate of 1.2%, going beyond the precedent set by the CMA in a number of other sectors (1% in RIIO-T2 and GD2).
- Ofgem's proposal to reject several of our UMs, despite strong evidence and relevant precedent in other sectors (e.g. wayleaves and subsea cables in T2), means we will be inadequately equipped to manage key risks outside of our control.
- Ofgem's approach to setting capitalisation rates is unreasonable, with no evidence supporting Ofgem's 98% capitalisation rate for UMs.
- The DD creates significant risk through an unjustifiably asymmetric incentive package, which is more weighted towards the downside, coupled with significant cuts in allowances.
- Ofgem's proposal on inflation is inappropriate as it breaks from regulatory precedent and previous commitments, including Ofgem's policy position set out in the SSMD for RIIO-ED2.

13 It is important to recognise that not just the energy network sector looks to Ofgem's actions. The investability of the UK energy sector, and indeed the wider UK economy, is impacted by the credibility of the energy regulator. The purpose of arms-length economic regulation is to de-risk and de-politicise long term investment decisions. GEMA needs to demonstrate that it is properly balancing the needs of current and future consumers while ensuring that regulated bodies can finance themselves and while contributing to sustainable development. If GEMA fails to act properly in relation to networks, it has direct read across to the financeability of new generation (such as new renewables and nuclear) and also undermines its ability to effectively intervene in the supply sector.

14 We have reviewed Ofgem's impact assessment for the DD, and consider that it does not adequately and comprehensively assess the impact of key policy and cost assessment proposals. This includes in relation to the impact of its proposals on financeability, interactions with other key policy changes such as the Access Significant Code Review (ASCR) and the already-signalled reviews of key price control components in-period, for example relating to DSO and Guaranteed Standards of Performance. The impact assessment further does not capture the risks and uncertainties faced by consumers in more remote locations such as the North of Scotland. **We also note that Ofgem has not explicitly considered the impact the level of cuts it is applying in the DD will have in the context of its duties and obligations to protect both current and future consumers, the need to maintain security of supply and reduce carbon emissions.** Significant further analysis is required to ensure a robust impact assessment in line with Ofgem's obligations under Section 5A of the Utilities Act 2000.

15 Ofgem has not followed its own processes resulting in unjustified cuts, and has limited our ability to provide a constructive and informed response to its Draft Determination. We have noted a number of issues with Ofgem's process. These include:

- Critical additional evidence being provided late in the consultation period, including a fully functioning modelling suite and additional feedback on our engineering justification, thereby limiting our ability to provide a fully considered consultation response.
- Significant departure from previously signalled policy, including in the context of cost assessment methodologies, creating additional complexity and significantly increasing the risk of material errors.
- Significant policy decisions still outstanding, and new obligations being introduced late in the process, with insufficient detail to understand the impact on our business plan.

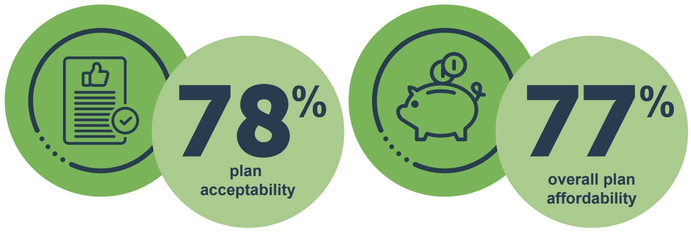
16 We provide a more detailed description of our concerns and associated impact in Annex 6. We look forward to continuing our constructive engagement with Ofgem in the run up to its Final Determination to ensure the impact of any process issues is appropriately mitigated.

[11] *www.gov.uk/government/publications/british-energy-security-strategy/british-energy-security-strategy*

Ofgem's approach is out of step with stakeholder ambitions and puts half of our business plan outputs at risk

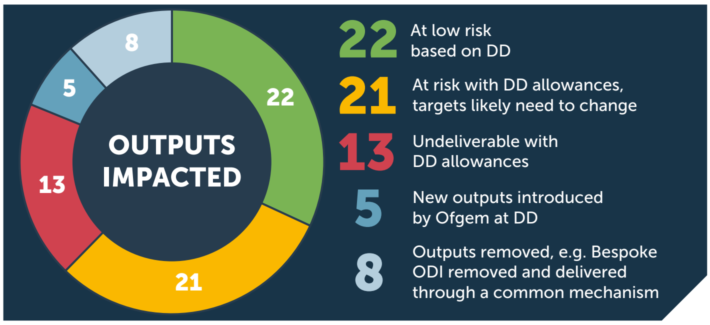
17 In line with Ofgem's sector-specific methology decisions, business plan guidance and enhanced engagement guidance, our business plan was co-created with our customers and stakeholders.

18 Our final business plan was robustly tested with our customers, scoring highly on acceptability and affordability across all areas. Only 4% of customers found our business plan unacceptable.



19 However, Ofgem's DD will have a significant negative impact on the level of outputs we will be able to deliver. Ofgem's approach would result in material underfunding, and would mean that we would be unable to deliver the outputs we co-created and agreed with our stakeholders.

20 As such we have revised our view of key outputs and deliverables to reflect the allowances proposed by Ofgem in DD.



- Our original business plan included 64 output commitments across our three strategic outcomes, determined through extensive stakeholder engagement.
- The funding cuts under the DD makes 20% of these outputs undeliverable and means that the targets for a further 33% are at risk and will likely need to be adjusted.
- Full details are available in Annex 2. Given the nature of Ofgem's cuts, which are often applied top-down to individual cost categories, further work will be carried out in the run up to FDs and after FDs to fully assess how any final decision from Ofgem will impact the outputs we will deliver over RIIO-ED2.

21 Ofgem has outlined only at the highest level how it has incorporated stakeholder views in its decision-making process. In particular, Ofgem has not explained why it has discounted significant relevant stakeholder evidence.

22 Indeed, we engaged with over 25,000 stakeholders throughout the business plan process, and held 42 days of formal meetings and detailed discussions with our Customer Engagement Groups (CEG). However, we do not see that the outcomes of this process have been reflected in Ofgem's decision-making, including in the examples outlined in the following table:

BUSINESS PLAN AREA	OFGEM SUMMARY VIEW	SSEN VIEW
Scenarios and forecasting	Stakeholders and the RIIO-ED2 CEG expressed concern over whether expenditure was sufficiently justified given uncertainty in demand, and emphasised the importance of agile uncertainty mechanisms in responding to local net zero ambitions. These perspectives informed our Draft Determination proposals on baseline expenditure and the design of the LRE uncertainty mechanism toolkit.	• Ofgem has discounted our independent CEG's final report on our plan which states that "the CEG believes that SSEN has struck a balance between not foreclosing credible net zero pathways at the same time as protecting consumer bills."[12] • In addition, Ofgem has discounted the evidence we provided in our business plan of clear local authority support for the two most ambitous net zero scenarios: Consumer Transformation and Leading the Way.
Local planning	The CEG identified the importance of local planning to support net zero, recognising likely differing stages of policy commitments and whole system planning capabilities. The need for a more decentralised approach in line with local needs and circumstances is reflected in our Draft Determination proposals for smart optimisation and DSO reform.	• As above, Ofgem has discounted evidence of local authority support for our plan, moving away from a localised approach to net zero.

[12] *www.ssen-ceg.co.uk/wp-content/uploads/2022/01/CEG-SSEN-Report-Jan-2022.pdf*

BUSINESS PLAN AREA	OFGEM SUMMARY VIEW	SSEN VIEW
Uncertainty mechanisms	The CEG identified a need for agility in the ED2 framework to support net zero and reflect new or updated requirements on DNOs. This flexibility is reflected in our proposed uncertainty mechanisms, including proposed re-openers for Storm Arwen recommendations and DSO arrangements.	• With regards to our wayleaves and diversions UM, our CEG said that it "accept[s] SSEN's assessment of risk that costs are likely to grow both for diversions and for Injurious Affections (IA) compensation, based on past experience, and therefore that the UM seems appropriate." • With regards to ash dieback, our CEG noted that it "accepts the risk SSEN is facing in managing the risks of ash dieback and they do not yet know the volume and cost of work to remove dead and diseased trees." • With regard to our subsea cable repair UM, our CEG said in its report that it "accepts that the UM will allow SSEN to speed up the replacement of a failed cable to restore resilience and reduce back-up generation sooner than would otherwise be achieved. We believe this is in the interests of consumers." • Therefore it does not appear that Ofgem has taken our CEG's feedback in reaching a decision to reject our proposed UMs in these key areas.
Reliability and resilience	Our CEG identified the need to ensure robust obligations supported by a sufficiently strong incentive framework. This is reflected in our proposed setting of outputs and calibration of the ODI framework. It is also reflected in our review of Guaranteed Standards of Performance in line with Storm Arwen review recommendations.	• Ofgem has failed to give enough weight to the particular challenges we face in the North of Scotland as a result of regional factors, and has discounted clear evidence from key stakeholders supporting our strategic approach to managing our network in the North of Scotland. • As revealed through our stakeholder engagement and noted by our CEG, reliability and resiliece is a high priority for our stakeholders. Despite this, and noting the CEG's view that our final plan included "strengthed justifications for the investment", Ofgem has proposed significant cuts to our programme of reliability and resilience improvements, without clearly articulating the impact on our customers and communities.
Environment	Not mentioned by Ofgem	• We are disappointed to see that no mention is made by Ofgem of how it has accounted for the CEG and other stakeholder feedback in assessing Environmental Action Plans. • Mitigating our own impact on the environment was identified as a high priority by our stakeholders in the context of net zero and the climate emergency. • Ofgem has failed to recognise the valuable feedback provided by the CEG and other expert stakeholders in assessing the levels of ambition in DNOs' plans and highlighting best practice. As our CEG calls out, we were "the first DNO to set an accredited 1.5°C science-based target." Sustainability First (SF) notes that not all DNOs have committed to a 1.5°C target and those who haven't must catch up. SF also highlighted concerns with the significant levels of carbon offsetting in certain DNO plans.[13]
Business plan deliverability	The CG and CEG provided assessment on business plan deliverability given the scale of investment programmes proposed by DNOs and the increase against RIIO-ED1. This included the potential impacts on supply chains, opportunities for scale economies and risks to consumers. This has been reflected in our Draft Determination proposals for baseline TotEx, application of uncertainty mechanisms, and appropriate protection mechanisms.	• We recognise the importance of ensuring our business plan is deliverable. However we note that Ofgem's approach at the DD stage in fact exacerbates deliverability issues by significantly cutting baseline allowances. It is unclear how Ofgem's proposals to cut allowances associated with individual projects where it has raised deliverability concerns will improve deliverability and are in the interests of consumers. Ofgem appears to have ignored how our CEG highlighted "the importance of visibility of workload to marshal resources, reduce mobilisation times and inform the skills pipeline." • Feedback from the CEG also noted The Deliverabilty Strategy and associated Supply Chain Strategy are well researched and clearly articulated the validity of "the Deliverabilty Strategy and associated Supply Chain Strategy has been tested by third party experts." • We have included further evidence on how we have addressed deliverability concerns in Annex 7. We have continued to engage proactively with our supply chain to provide further evidence for the need for Ofgem to facilitate, rather than hinder, deliverability in RIIO-ED2.

[13] www.ofgem.gov.uk/sites/default/files/2022-03/Sustainability%20First%20-%20RIIO%20ED2%20Business%20Plans%20-%20CfE%20Response%20-%20Final%20090222.pdf

22 We have continued to engage with our stakeholders throughout the DD consultation process, to ensure the impact of Ofgem's proposals on jointly-designed outputs is fully understood. We engaged with over 1,100 stakeholders throughout the DD consultation period on key areas of our plan. This new evidence is important given it was gathered amidst the concurrent, climate, energy and cost of living crises we are experiencing now.

23 This has included local authorities, community representatives, experts in the field of vulnerability, fuel poverty and the environment, as well as key and industry leading supply chain partners. This includes the organisations outlined below, and full details of the engagement we carried out are available in Annex 1.

24 Our stakeholders' views are clear: Ofgem's DD will not deliver for customers and wider society and Ofgem must rethink its approach in Final Determination. On the next page, we set out the key themes and priorities we heard from our stakeholders throughout the DD response period.

25 In the remainder of this document, we outline areas where we consider Ofgem has committed material errors, and where its approach at DDs is not in the interest of current and future consumers.

26 We look forward to working closely with Ofgem in the run-up to its FD to ensure these are resolved and enable an acceptable outcome which meets the needs of customers, stakeholders and shareholders, in particular as regards the secure delivery of their electricity supply and the transition to net zero.

27 In order to ensure it meets its statutory duties and obligations, it is critical that Ofgem considers in full all the evidence provided in our consultation response before reaching a decision.

OUR DISTRIBUTION STRATEGIC OBJECTIVES

- Delivering a safe, resilient and responsive network
- Accelerating progress towards a net zero world
- Providing a valued and trusted service for customers and communities
- Making a positive impact on society

DON'T LOW-BALL NET ZERO: WE CAN'T PLAY CATCH UP ON DECARBONISATION

- Local authorities (LA) have ambitious decarbonisation plans but can't see the link between the DD and their input into plan.
- Ofgem's decision to aim lower than System Transformation, the lowest viable net zero pathway, has alarmed LAs and private sector stakeholders, including those impacted by demand constraints.
- Stakeholders are concerned that UMs will not be agile enough to meet the decarbonisation challenge. For our supply chain, planning and certainty regarding future demands are critical, particularly in light of unprecedented price volatility and resource constraints across the sector, exacerbated by war in Ukraine and a strong focus on net zero across Europe.
- Significant support from LA stakeholders for our Whole System CVP, who welcome Ofgem's decision.

CREDIBLE PATHWAYS TO 1.5ºC MUST NOT BE BLOCKED

- Citizens Advice recognised the positive benefits of our Life Below Water CVP, acknowledging the support it has received from the Challenge Group and the CEG.
- Stakeholders including Sustainability First share concerns on decisions impacting our Environmental Action Plan especially the disparity across DNO strategies including on SF_6 and losses, and the ability to achieve our ambitious 1.5°C science-based target.

NOW IS NOT THE TIME TO MAKE CUTS TO RESILIENCE FUNDING

- Stakeholders, particularly those in areas affected by the winter storms, are concerned by cuts to resilience spend and in particular Ofgem's call to make the Storm Arwen re-opener unavailable for DNOs to trigger until 2024.
- Scottish islands' stakeholders have expressed frustration at the disconnect between previous dialogue with Ofgem regarding the need for a strategic approach for the subsea cable network, and what has been proposed in the DD.

VULNERABLE CUSTOMERS NEED TO BE ABLE TO ACCESS SUPPORT

- Stakeholders have backed our commitments to support customers in vulnerable situations. In particular, consumer advocate groups were supportive of our Personal Resilience Plans CVP and want to see consistency in approach more widely to our Priority Services Register customers.
- Fuel poverty agencies and national charities have concerns about Ofgem's proposed cuts to fund energy efficiency measures, including our proposals for energy efficiency training and enhanced training for our vulnerability champions.

OUR SUPPLY CHAIN PARTNERS HAVE EMPHASISED THE IMPORTANCE OF CERTAINTY AND PLANNING

- We have received key feedback from a number of our strategic supply chain partners. They have been united in expressing concerns about Ofgem's over-extended use of UMs due to the critical importance of planning and certainty regarding future demands in order to mitigate significant volatility in material availability and unprecedented raw material price increases.
- This recent feedback builds on the clear messaging we heard from them during business plan engagement, when they confirmed that visibility of SSEN pipeline and committing volumes of work to the supply chain, are absolutely critical to enable the suppliers and industry as a whole to recruit and train the necessary resources and expertise to deliver ED2.

NETWORKS FOR NET ZERO

ISSUE/ERROR	CUSTOMER IMPACT	RESOLUTION	REF
Ofgem's decision to revert to System Transformation and remove £23m of strategic investment from the baseline plan is in direct contradiction to its business plan guidance and stakeholder feedback.	Inability to plan strategically and meet net zero. Reduced opportunity to drive efficiency through our supply chain. Exacerbated delays for customers seeking to connect.	Reinstatement of the £23m dedicated strategic investment funding included in our original submission back into the baseline plan.	CORE - Q66, Q67, Q105
Erroneous application of untested and unjustified top-down demand driver adjustment.	Overly aggressive top-down reduction of our baseline by £84m, resulting in a baseline plan which is not net zero compliant.	Demand-driver adjustment to be applied to load-related expenditure only. Further adjustments to ensure mechanism accurately reflects our business plan and the true potential impact of LCTs on our network.	CORE - Q105
Load volume driver unit costs are not reflective of true costs likely to be incurred, and must account for CAIs. Introduction of volume driver cap could needlessly restrict our ability to react to customer demand increases.	Inability to plan strategically and meet net zero. Exacerbated delays for customers seeking to connect.	Well-designed secondary load volume driver that enables efficient investment through: (i) efficient and reflective DNO specific unit costs, (ii) efficient funding of support costs in line with RIIO-ED1, RIIO-T2 and RIIO-GD2 precedent, (iii) recognition of additional costs associated with moving baseline expenditure to uncertainty, in particular in current macro-economic climate In principle, approach to volume drivers should be aligned across load and PCBs	CORE - Q4 Annex 11
Error in the calculation of unit rates for secondary reinforcement, complicated by different interpretations of the CV2 table.	Incorrect volume data causing modelling errors, linking to setting unit rates for the UM may drive insufficient volume delivery.	Ofgem needs to ensure the correct data is used and DNOs populate CV2 consistently.	CORE - Q67
Use of median £/MVA benchmark as part of disaggregated modelling adjustments for Primary load related expenditure is not fit-for-purpose in SHEPD.	Reduced ability to deliver reinforcement required to connect renewable generation and meet net zero targets in SHEPD.	For circuits, or substation groups, Ofgem should use a £/MVA/km metric. This will consider the benefits of releasing more MVA to the network and the higher cost in doing so whilst also accounting for length of the asset being reinforced.	CORE - Q65
Lack of clarity on how flexibility is to be funded through price control	Risk that framework disincentivises the use of flexibility as an alternative to network reinforcement	Ofgem should be clear on how flexibility should be funded, and enable direct funding through the secondary load volume driver.	SSEN - Q6 Annex 11
Stakeholder-supported activities in our Environmental Action Plan removed, including Fluid Filled Cables (FFC), SF_6 and nature-based solutions	Significant threat to our ability to meet our 1.5°C SBT, in line with legislative targets, stakeholder support and Ofgem's own Business Plan Guidance.	Reinstatement of the £31m required investments into our modelled allowances. We have provided additional evidence to directly address Ofgem feedback, as well as further evidence of stakeholder support.	CORE - Q13 Annex 8

SUPPORTING A SMARTER, MORE FLEXIBLE, DIGITALLY- ENABLED ENERGY SYSTEM

ISSUE/ERROR	CUSTOMER IMPACT	RESOLUTION	REF
Assessing IT/OT costs at licensee-level does not accurately reflect the way in which companies manage these costs (at group level) and is an unexplained departure from the ED1 approach (noting these costs were only assessed as part of Totex for T2 and GD2). Assessing IT/OT costs over two regulatory periods (ED1 and ED2) is not appropriate given the significant new and well-recognised challenges we will face in RIIO-ED2.	Additional unjustified cuts to our IT/OT allowances fail to recognise critical role digitalisation plays across our entire plan, for example in delivering net zero and meeting changing customer expectations. Ofgem methodology does not recognise significant investment required enable better customer service and to meet new reporting and licence obligations.	IT/OT costs must be assessed on a company-basis. IT/OT costs must be assessed on an ED2 basis only. MEAV is not an appropriate driver for indirect costs; Qualitative Assessment required in key areas.	CORE - Q79 Annex 16
Introduction of new reporting requirements and obligations relating to digital, and relating to whole systems.	New unfunded obligations being introduced despite significant cuts in allowances. Whole system licence obligation is very high-level and the intent is unclear. Could result in funding being rerouted away from customer-driven outputs in order to ensure regulatory obligations are met.	Cuts in allowances for IT/ OT must be mitigated through appropriate approach to cost assessment, that reflects the changing nature of requirements in ED2 (see above). Appropriate mechanisms must be put in place to ensure companies are appropriately funded for the efficient costs associated with the introduction of new obligations.	CORE - Q79
Only one year of cyber-security activities' funding provided, despite firm recognition from Ofgem of need and justification	Increases risk of serious cyber-security breaches. Reduces our ability to plan resources and work with our supply chain, likely increasing costs. Creates additional unnecessary administrative burden through the operation of the reopener, where costs have already been confirmed as certain and justified by Ofgem.	Full up-front funding for cyber-security activities. Retention of uncertainty mechanism to deal with potential future changes to requirements.	CORE - Q79
The interaction between the engineering assessment of IT and OT EJPs is unclear, with limited feedback provided	Risk of key projects not going ahead, constraining the services we can deliver to our customers and our ability to meet new requirements and obligations set by Ofgem.	Appropriate funding in FDs so we can meet customer expectations and changing obligations, based on the additional evidence we provide to address Ofgem feedback in Annex 16.	CORE - Q79 Annex 16
Subjective approach to measuring DNO performance under DSO Strategy Delivery Incentive (SDI)	Risks skewed results which do not truly reflect DNO performance, leading to unjustified penalties.	Rebalance quantitative and qualitative measures to ensure a fair process.	CORE - Q25

MEETING NEEDS OF CONSUMERS AND NETWORK USERS

ISSUE/ERROR	CUSTOMER IMPACT	RESOLUTION	REF
Overall incentive package is asymmetric and heavily weighted towards the downside despite significant cuts in allowances.	Creates additional risk not factored into the price control framework.	Introduce a more balanced incentive package, and ensure incentive designs and targets are well designed to ensure DNOs are appropriately and objectively rewarded and penalised, recognising factors outside their control. Ensure sufficient funding is provided to meet targets. Consider cost to serve relationship, noting significant cuts applied across entirety of our plan.	All incentive-related questions CORE - Q106
Vulnerability incentives survey targets for fuel poverty are not rooted in evidence.	DNOs are likely to be penalised for factors outside of their control, in particular in the context of the wider cost of living crisis.	Use evidence provided by ourselves in order to set targets that are achievable and will incentivise DNOs to improve services for their customers.	CORE - Q34
Approach to Major Connections ODI is unbalanced and does not account for funding cuts to our load plan. Inclusion of competitors in survey could distort competition.	DD cuts will have an impact on our ability to invest strategically in the network and connect customers to our network. Penalty-only “all or nothing” mechanism inappropriate and fails to recognise the impact of factors outside our control on our ability to connect customer.	Ensure appropriate funding is available through our load plan (see above). Remove requirement to survey competitors or include on a reputational basis only.	Core -Q39

MAINTAINING A SAFE AND RESILIENT NETWORK

ISSUE/ERROR	CUSTOMER IMPACT	RESOLUTION	REF
Modelling for asset replacement and refurbishment activities represents a significant change in approach. Alternative methodologies such as the survivor model were applied inconsistently across DNOs and not supported by clear principles.	Unjustified cut of £58m impacting our monetised risk targets. Reduced resilience spend will put longer-term resilience of our network at risk in context of climate change.	Utilise existing Network Asset Risk Metrics (NARMs) methodology to set allowances instead of alternative methods such as outdated survivor models, reinstating £58m into the modelling.	CORE - Q54
Significant volume reductions not reflected in revised NARM monetised risk target, with Ofgem departing from previously stated policy that DNOs should be funded to deliver their targets. Ofgem is inappropriately pre-empting outcome of the ED1 close-out process and applying this to the ED2 volumes.	DNOs not funded to deliver core risk reduction target developed and agreed with customers. Additional hidden efficiency of £210m, reducing our ability to deliver our original monetised risk target by 23%. Reduced resilience spend will put longer-term resilience of our network at risk in context of climate change.	Reinstate volumes or reduce NARM monetised risk targets to match the allowances provided.	CORE -Q54 Annex 15
Significant unjustified cuts to our programme of LV and HV cable replacement works. Based on Ofgem's methodology it would take us between 600-1,000 years to replace these critical assets that are reaching end-of-life.	Reduced reliability and resilience of the network resulting in increased network faults and potential IIS impact. Constraints on our ability to deliver a network that will be fit for purpose for net zero. Illogical outcome of cost assessment that is obviously not in the interests of customers.	Volumes of work for LV and HV cables must be reinstated, in line with the additional evidence we provided. This would result in a £35m increase in allowances.	CORE - Q73 Annexes 7 and 15
LiDAR data not accepted as justification for vegetation management / tree-cutting activities, though accepted as justification for Overhead Line Clearances (OHL), resulting in significant cuts of 57%. Error in disaggregated modelling, with models not matching methodology set out in DDs.	Allowances required to meet legal obligations relating to safety as set by the HSE. Secondary impact on customers through reduced reliability of our network. Will require us to reroute funding away from other outputs to ensure we meet our legal obligations.	Accept LiDAR data as justification, reinstating volumes and resulting in a £28m increase in allowances. Adjust disaggregated modelling to match methodology set out in DDs (using "spans cut" instead of "spans affected").	CORE - Q97
Rejection of our ash dieback uncertainty mechanism, despite clear evidence of cost and volume uncertainty associated with ash dieback.	Safety and reliability implications as noted above. SSEN asked to carry risk clearly outside of management control. Costs were deliberately excluded from our baseline to protect customers from uncertainty.	Approve introduction of UM, with funding for survey included in baseline. Increased baseline allowance required as an alternative, in the range of £63m-£339m. Further work required in run-up to FDs to determine final value.	CORE - Q97 SSEN - Q8

ISSUE/ERROR	CUSTOMER IMPACT	RESOLUTION	REF
Rejection of our wayleaves and diversions UM, despite clear evidence of cost and volume uncertainty. No recognition from Ofgem of RIIO-T2 precedent and potential discrimination issues this may create at 132kV level. Mixed messages from Ofgem noting acceptance of risk in EJP review.	Will require us to re-route funding away from other outputs to ensure we meet our legal obligations. SSEN asked to carry risk clearly outside of management control. Failure to recognise that costs were deliberately excluded from our baseline to protect customers from uncertainty.	Introduce closeout mechanism for injurious affections, in line with RIIO-T2. Introduce re-opener for physical diversions, in line with approach taken for rail diversions. Increased baseline allowance required as an alternative of up to £82m. Further work required in run-up to FDs to determine final value.	SSEN - Q8
Ofgem's DD approach to the North of Scotland is not consistent with either meeting Scotland's net zero duty or investing in network resilience as envisaged by Ofgem and our customers. It would not enable us to take a strategic approach to managing our network in the North of Scotland, and fails to recognise the risks we face due to the unique geography of the region.	Reduced reliability and resilience of our network. Reduced ability to connect renewable generation and meet net zero targets. Fix on fail is "Must do" activity without a UM we will need to reroute funding away from other outputs to ensure we meet our resilience obligations. Eight cables rejected compared to 13 cables put in our plan1.	Ofgem to facilitate strategic approach in North of Scotland, in line with SSEN and Ofgem discussions with stakeholders. Appropriate baseline to fund strategic and proactive cable replacement for 13 cables (£77m). Approve introduction of subsea cable 'Fix-on-Fail' Uncertainty Mechanism, noting RIIO-T2 precedent in this space. Increased baseline allowance for faults required as an alternative.	Annex 10

DELIVERING AT LOWEST COST TO ENERGY CONSUMERS

ISSUE/ERROR	CUSTOMER IMPACT	RESOLUTION	REF
Ongoing Efficiency (OE) target based on selective and erroneous use of evidence: all evidence sources bar one point to a lower OE target; the use of this evidence point is flawed as it has not been considered over complete business cycles; and is not applicable to Totex.	Target is unreasonable and unachievable, and well above that set out by the CMA in RIIO-ED2 and GD2. This will inhibit our ability to deliver the outputs we co-created with our stakeholders and be detrimental to delivery of net zero.	Our proposed OE of 0.7% p.a. is more stretching than using EU KLEMS data range output (0.1-0.6%) from Oxera; based on sensitivity analysis and other sources of evidence consistent with presented evidence from CEPA. Three independent economic advisors value maximum OE at less than 1% p.a. Therefore, any ongoing efficiency target above 1% cannot be reasonably justified by evidence.	CORE - Q110 Cost Assessment Annexes (B, C, D and E)
Catch-up Efficiency target moving from 75th to 85th percentile is flawed. Disaggregated modelling benchmark is set beyond current best practice to unachievable, hypothetical company.	Target is unreasonable and unachievable, and well above that supported by model fit / robustness in RIIO-ED2. Ofgem say move to 85th percentile immaterial, but this is worth £24m, >1% of Totex This will inhibit our ability to deliver the outputs co-created with stakeholders and detrimental to delivery of net zero.	Ofgem should utilise an efficiency target that is reflective of both the data and current macro factors, which we believe should be below the 75th percentile.	CORE - Q110 Cost Assessment Annex E
Significant departure in cost assessment approach set out at ED1 and T2/ GD2 which was not signalled in advance.	Unjustified cuts and lower allowances will inhibit our ability to deliver the outputs we co-created with our stakeholders and act as an enabler to net zero.	We outline in our response where we think Ofgem's approach departs from ED1 and T2/ GD2 without appropriate justification, and propose an alternative including: - IT/OT, and IT Business Support Costs (BSC): assess on company rather than licensee basis; - Tree Cutting volume adjustment to be removed and efficiency assessed on activity level - Indirects to consider activity level driver in regression modelling, such as asset additions	CORE - Q64, Q107 Cost Assessment Annexes Annex 5 Annex 6
Numerous material errors in applying cost assessment methodology.	SSEN underfunded and constrained in its ability to deliver net zero and meet customer expectations.	Comprehensive list of errors and proposed solutions included in Annex 5	Annex 5
Recognition of need for new control rooms by Ofgem welcomed. Additional evidence provided to justify solution and associated costs.	As we have demonstrated, new control rooms required to meet challenge of net zero and further develop our DSO roles and responsibilities.	Removal of £4.4m BPI penalty and approval of £44.5m in control room expenditure, in line with additional evidence provided in Annex 9.	CORE - Q84 SSEN - 7 Annex 9
CAI and BSC reduces spend levels for all DNO groups back to ~19/20 spend levels and there is no mechanism at present for Indirect Costs associated with uncertainty mechanisms. The use of MEAV as a driver in CAI and BSC is inappropriate as it does not attribute appropriate weightings for the time it takes to carry out the CAI activities.	Unreasonable for all DNOs considering the level of new outputs required in ED2 and the Totex growth compared with ED1.	MEAV should be recalculated for use when assessing CAI and BSC with a materially reduced weighting on underground cable (1.5x instead of 8x) compared to overhead line to reflect the similar level of Indirects required in line with additional evidence provided. Account for indirects within volume driver UMs as per precedence in Transmission.	CORE-Q102 Cost Assessment Annex E

ISSUE/ERROR	CUSTOMER IMPACT	RESOLUTION	REF
Rejected a number of company-specific factors which were accepted in ED1 due to erroneous assessment of company-level efficiency.	We will be constrained unless our additional costs relating to Scottish islands including subsea and associated sparsity are separately assessed. Company-specific factors cannot be rejected on the basis of comparative efficiency between DNOs but must be based on the evidence of the challenges and costs that our unique geography brings.	Remove and separately assess the company-specific factors of £223m including subsea, islands and sparsity from the cost modelling in line with evidence provided in Annex 10 and Cost Assessment Annex E.	Annex 10 Cost Assessment Annex E
Flawed assessment regarding the inter-regional mobility negating the need for Scotland Regional Wages.	As we have demonstrated, wages in Scotland are persistently higher than in other regions with reduced inter-regional mobility in the foreseeable future.	Apply a Scotland-specific regional wage adjustment alongside the SE and London adjustment, or alternatively, a wage adjustment for every region, as supported by our evidence in Annex D F.	Cost Assessment Annex F

FINANCE AND FINANCEABILITY

ISSUE/ERROR	CUSTOMER IMPACT	RESOLUTION	REF
The Cost of Equity allowance has been set too low and is not reflective of market evidence. This causes financeability issues on both an equity and a debt basis. There is substantial evidence presented at the CMA and additional "new evidence" that shows Ofgem have made errors in relation to key components of the Cost of Equity (CoE). This includes: Incorrectly setting the Total Market Return (TMR) using a flawed inflation series which has now been proven by the Office of National Statistics (ONS). Incorrectly setting of the beta by using an incomplete sample. The sample wrongly includes water companies and excludes appropriate European energy networks. Detailed analysis of price controls across sectors evidences the comparability of the beta sample. Incorrectly relying on flawed cross- checks when setting the cost of equity such as Offshore Transmission Owner returns, incorrect application of the academic theory, and reliance on Market to Asset Ratios (MARs). Ofgem should be using superior cross-checks such as the Asset Risk Premium to Debt Risk Premium analysis (ARP vs DRP) as well as multi-factor models. As a result, Ofgem have relied upon an incorrectly defined notional company in order to mask a material financeability issue over RIIO-ED2.	Leads to equity investors subsidising debt investors by virtue of negative dividend yields over the period i.e. net equity injections on the ex-ante funded totex expenditure set in DDs. The low CoE causes material downward pressure on credit ratios over the period leading to at least a one notch downgrade. This worsens further when factoring in net equity injections and excessively high assumption on Index Linked Debt (ILDs), credit ratios worsen significantly further. Risks leading to underinvestment over the period due to financeability constraints on equity and debt financing.	An adjustment to the methodology for setting the Cost of Equity to reflect the most reliable and observable evidence and inputs when setting the CoE. Reliance on the superior cross checks and correcting for Ofgem errors on downward adjustments to key elements of the CoE. An increase to the CoE to at least 5.9% based on analysis by Oxera[14]. When factoring in the asymmetric nature of incentives (or Ofgem could make ODIs symmetrical as we have advocated in our response), Ofgem must go higher than 5.9% to maintain ratios required to achieve the target credit rating. This is consistent with the regulatory precedent on PR19 as set by the CMA[15]. This assumes Ofgem corrects errors when setting totex allowances and Uncertainty Mechanisms.	Finance Annex
The Cost of Debt (CoD) allowance is likely to lead to underfunding for the notional DNO given changes in interest rate forward curves and any plausible high interest rate scenario. This is accentuated when coupled with high investment scenarios over RIIO-ED2.	Likely to lead to underfunding of the cost of borrowing thereby costing debt financeability issues. May lead to underinvestment due to cash flow constraints.	An adjustment to the Cost of Debt allowance is required to reflect rising interest rates and plausible scenarios of higher interest rates over RIIO-ED2. The CoD allowance needs to increase by at least 30-40bps including allowing for the infrequent issuer premium of 6bps which Ofgem disallowed without appropriate justification.	Finance Annex
The balance of risk in the price control is asymmetrically negative across each parameter of RIIO-ED2. This is the opposite of their policy intent to de-risk RIIO-ED2. This covers: Totex Cost Allowances and the efficiency challenges (such as efficiency cuts and Ongoing Efficiency reductions) are overly aggressive and unrealistic including retaining substantial unfunded outputs. Disallowance of Uncertainty Mechanisms i.e. unfunded Totex that is would materialise from uncertainty without the regulatory mechanism available to secure additional totex funding. Asymmetric nature of ODIs where the mid-point is (-1%). Changing weather patterns due to climate change, thereby causing downside compensation costs and rising fault costs.	Likely to cause downward pressure on financeability due to the asymmetric nature of the price control. May deter investment over the period as a result of requiring equity injection to subsidise debt investors despite the increasing equity risks.	Ofgem must correct for the errors identified in setting totex cost allowances and UMs. Ofgem must at least aim upwards when setting the cost of equity to reflect the asymmetric nature of ODIs in line with the CMA decision on PR19 as noted in the previous section[16]. Alternatively ODIs could be made symmetrical as we have advocated throughout our response.	Finance Annex

[14] This is based on analysis by Oxera set out in their report on Financeability for SSEN. A CoE of 5.9% CPI-real is based on assuming the Cost of Debt is fully funded and totex allowances are reinstated to ensure all outputs and obligations can be delivered. This also does not factor in the need to "aim up" when setting the CoE particularly when incentives are materially asymmetric.

[15] The CMA aimed up by around 0.25% for PR19 to accommodate the asymmetric nature of the price control and financeability concerns.

[16] This is after increasing the CoE to 5.9% as a minimum over the period after correcting for the underfunding of the CoD allowances.

ISSUE/ERROR	CUSTOMER IMPACT	RESOLUTION	REF
Ofgem's financeability analysis is flawed. When the analysis is adjusted to reflect an appropriately defined notional company and adjusted for net negative dividend yields, the credit rating is likely to fall by one notch below the targeted investment grade rating. When considering underfunded totex allowances, disallowed UMs, and asymmetric incentives, the credit rating falls below investment grade i.e. below BBB-. This is significantly below Ofgem's targeted credit rating.	This would lead to a downgrade given errors identified elsewhere in the price control. This would deter investment by causing financial constraints and the need for equity investors to subsidised debt investors over the period.	Ofgem must correct for the errors identified in setting the CoE, the CoD, totex cost allowances and UMs. This would also include aiming up on the CoE in line with regulatory precedents or making ODIs symmetrical.	Finance Annex
Capitalisation rate for Uncertainty Mechanisms (UM) is inappropriate. The 98% rate used does not reflect the natural rate or the basis for regulatory precedents in RIIO-T2 whereby it was set below the natural rate to support equity fundraising during high investment periods. This leads to a significant increase in equity financing over RIIO-ED2 under any UM totex scenario.	Inappropriate and causes downward pressure on credit ratings ratios.	Ofgem must update their analysis and provide adequate justification as to why 98% would be appropriate. Furthermore, why is the natural rate not simply extended or blended from the baseline totex allowances. Evidence shows this should be lower and would also be reflective of regulatory justifications in RIIO-T2. Based on our analysis, this should be changed from 98% down to 75-85%.	Finance Annex
The Ofgem Annex on inflation is inappropriate as it breaks from regulatory precedent and the commitments made as part of the price control including the SSMD. Ofgem has not consulted or presented any evidence that there are any issues with the treatment of inflation in RIIO-2. It is an error to adjust inflation as a result of a period when inflation is higher than the Bank of England target. No evidence has been presented to show that it adjustments are required to inflation treatment in RIIO-2. Ofgem has made no assessment of the impact including on risk exposure and financeability of network companies.	Introduces regulatory uncertainty, instability, and risks undermining investor confidence. This could give rise to material Financeability concerns particularly given industry exposure to Index Linked Debt and inflation linked costs. Likely to lead to a significant increase in the Cost of Capital over time compared to inflation protected returns. This will increase costs to consumers.	This created significant regulatory uncertainty and will lead to a material change in the regulatory framework. Ofgem must avoid this error and focus on the core elements of the price control. The high inflation environment must not be considered in isolation and there is no evidence or justification to change inflation treatment in RIIO-2. This would be a material breach in regulatory process at this late stage of a price control and is a deviation from Ofgem's policy decision at the SSMD for RIIO-ED2.	Finance Annex
The regulatory treatment of the Shetland Link contribution must be refined to reflect the appropriate accounting and tax treatment. This is an outstanding technical item that must be resolved including reflecting the appropriate capitalisation and tax treatment.	Timing of cash flows and bill impact, should match underling accounting and tax treatment to avoid a mismatch in regulatory and statutory treatment.	To be finalised in line with accounting and tax practice. This should remain an open item during the price control period due to its uncertainty in timing and regulatory treatment.	Finance Annex

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