

BEFORE THE COMPETITION AND MARKETS AUTHORITY
IN THE MATTER OF AN APPEAL
UNDER SECTION 11C OF THE ELECTRICITY ACT 1989

BETWEEN:

British Gas Trading Limited

Appellant

v.

The Gas and Electricity Markets Authority

Respondent

**ADDITIONAL SUBMISSIONS BY
SP MANWEB PLC AND SP DISTRIBUTION PLC
AS INTERESTED THIRD PARTIES**

A. INTRODUCTION

1. In these Additional Submissions, SP Manweb plc (**SPM**) and SP Distribution plc (**SPD**) address two points by way of supplement to Part E of the Slow-Track DNOs' Joint Submissions dated 22 April 2015 (which responds to the allegations in section 4(3) of BGT's NOA regarding IQI).
2. The same abbreviations are used as in the Joint Submissions unless otherwise stated. SPM and SPD share common management and ultimate ownership, and are together referred to as **SPEN**.
3. SPEN's two additional points relate to:
 - (1) The basis on which the Authority made adjustments for smart grids.
 - (2) The accuracy of the forecasts for RPEs.

B. CONTEXT

4. These points arise because of BGT's submissions in paragraphs 4.61(b) and 4.62(c)-(e) of the NOA.
5. In paragraph 4.61(b), BGT refers to a letter it received from the Authority dated 3 February 2015, in which the Authority stated:

*"... our Final Determinations efficiency analysis applies two sets of adjustments after the upper quartile calculation: (a) adjustments for Real Price Effects; and (b) adjustments for incremental smart grids efficiencies. One of the consequences of this was that no DNOs or DNO groups outperformed our final cost benchmarks. If we had made no changes to the break-even this would have meant no DNOs would have received rewards under the IQI for providing better forecasts. This would have been inconsistent with our Strategy Decision, as set out above. ..."*¹

¹ Para. 25 [BG2/39/7].

6. In paragraph 4.62(c), BGT alleges that the changes which the Authority made to the IQI break-even:

“cannot be justified by reference to the Authority’s efficiency adjustments by reason of expected smart grid benefits and real price effects.”

7. In respect of smart grid benefits, BGT alleges in paragraph 4.62(d) that:

“The adjustment for smart grids reflects the collective inadequacy of DNOs’ business plans in quantifying the efficiencies achievable by this new technology ... when the Authority considered the business plans, it found that the DNOs had collectively failed to pay sufficient regard to the efficiencies achievable from smart grids. Its adjustment was made because of the deficiencies in the DNOs’ business plans. If anything, the Authority considered the adjustment that it made to be conservative ... In the circumstances, there was no justification for adjusting the IQI to save DNOs from the consequences of their failure to prepare robust business plans in relation to smart grids. ...”

8. In respect of RPEs, BGT alleges similarly in paragraph 4.62(e) that:

“... By the time that the DNOs submitted their business plans in March 2014, the DNOs should already have had a reasonable view of 2012/13 data and some sight of developments in 2013/14. They could have been expected to adjust their business plans accordingly, and should not be rewarded for poor forecasts.”

9. BGT’s allegations are misguided, for the reasons summarised in these Additional Submissions. SPEN deals with them relatively briefly, because of the CMA’s directions as to brevity, and also because the smart grid adjustment and RPEs are the subject of a separate appeal to the CMA under section 11C of the 1989 Act. SPEN expects that the CMA will benefit from full submissions on these issues from the Authority and the appellants (Northern Powergrid (Northeast) Ltd and Northern Powergrid (Yorkshire) plc). However, should the CMA find it of assistance, SPEN will provide further submissions together with any necessary expert reports and witness statements.

C. THE SMART GRID ADJUSTMENT

10. BGT is wrong to allege that the DNOs failed to pay sufficient regard to the efficiencies achievable from smart grids, for the following reasons. In summary, the assessment of the smart grid benefits in the DNOs’ business plans conducted by the Authority is insufficient to support BGT’s allegations.

The Authority’s approach to assessing smart grid efficiencies involved double-counting

11. Each DNO’s business plan included savings from smart grid technologies. In order to quantify each DNOs’ smart grid adjustment, the Authority used a “double benchmarking” method, involving two stages:
- (1) At stage 1, the Authority carried out its general cost assessment benchmarking, comparing each DNO’s business plan using econometric models. Each DNO’s business plan already included smart grid savings. The Authority’s assessment was based on benchmarking – for the most part against the upper quartile. The Authority concluded that SPD’s proposed expenditure was efficient by 4%, and that SPM’s proposed

expenditure was inefficient by 11%.² SPD's and SPM's allowances were adjusted accordingly. This outcome therefore already took into account adjustments to allowed smart grids against a benchmark.

- (2) At stage 2, the Authority then carried out a further, specific smart grid cost assessment in accordance with a further benchmarking methodology. On this basis, the Authority adjusted SPD's allowances downwards by an additional £55 million and adjusted SPM's allowances downwards by an additional £60 million.³
12. This two-stage approach resulted in a target for smart grid savings being applied on top of a cost target (which included smart grid savings) already derived from the general benchmarking. Both benchmarking exercises therefore took into account efficiencies arising from smart grids.
13. The overall result is “*double benchmarking*” and a “*double count*” of supposed savings from smart grids. The Authority's approach leads to a very demanding benchmark.

No justification for asserting that DNOs included insufficient smart savings

14. BGT's assertion that DNOs understated their smart grid savings is not supported by any reliable evidence cited by the Authority in the Decision or by BGT in the NOA. The Authority's Draft⁴ and Final⁵ Determinations do not contain any reliable evidence to support suggestions of understatement.
15. SPEN would add that, in any event, the double benchmarking method would be an unreliable and severe means to identify any industry-wide understatement. It assumes that all DNOs are equivalently capable of benefiting from smart grid technologies and is not justified by specific assessment of the ways in which DNOs may have understated smart grid benefits.

The smart grid adjustment was developed late in the RIIO-ED1 process

16. BGT state in paragraph 4.62(d) of the NOA that:
- “The Authority's Strategy Decision [BG2/10-A] at §§3.17 and 3.20 put the DNOs on notice of the need to reflect the efficiencies resulting from the costly smart grid investments which consumers are funding.”*
17. This is incorrect. The Authority's Strategy Decision⁶ cannot be read as foreshadowing or contemplating a separate smart grid adjustment. No such adjustment was proposed during the Fast Track stage, and no such adjustment was proposed in the Authority's assessment of each DNOs' Fast Track business plan.⁷ No such adjustment had been proposed by the time when the DNOs submitted their Slow Track business plans in March 2014.
18. In fact, a smart grid adjustment was first proposed at Draft Determinations (30 July 2014), after the DNOs had submitted their business plans.

² Final Determinations – Business Plan Expenditure Assessment (28 November 2014), Table 2.3 [BG2/35B/12].

³ Ibid., Table 2.5 [BG2/35B/14].

⁴ [BG2/30] (30 July 2014).

⁵ [BG2/35] (28 November 2014).

⁶ [BG2/10] (4 March 2013).

⁷ See [BG2/16] (22 November 2013).

19. After the end of the Draft Determinations consultation period (26 September 2014), the Authority then changed its approach to the calculation of the smart grid adjustment by introducing the double benchmarking method described above.
20. Accordingly, to the extent that the Authority consulted about the double benchmarking methodology, its consultation was at a late stage and was both limited and informal.

Other concerns

21. SPEN has other concerns with the Authority’s assessment of smart grid efficiencies. For example, the Authority appears not to have properly addressed whether each DNO is capable of employing the relevant smart grid solutions, and, therefore, whether each DNO can actually achieve the smart grid savings.

D. RPEs

22. BGT asserts that the DNOs “*should not be rewarded for poor forecasts.*” The inference is that SPEN submitted a poor forecast of RPEs.
23. BGT’s assertion is without foundation. SPEN did not submit a poor forecast. SPEN engaged First Economics (a reputable economics consultancy) to provide the forecast used in SPEN’s March 2014 business plan. First Economics’ forecast was produced to the Authority as an annex.⁸ BGT adduce no evidence that SPEN’s forecast was poorly prepared. The CMA is invited to assess First Economics’ work for itself.
24. The fact that the Authority reduced the DNOs’ allowances on the basis of its own analysis does not mean that the SPEN’s forecasts were “*poor*”.

E. CONCLUSION

25. For the above reasons, and the reasons set out in the Joint Submissions, SPD and SPM should not be disadvantaged under the IQI due to the smart grid adjustment and adjustment to the forecast of RPEs, as BGT seem to suggest.

Statement of Truth

SP Distribution plc and SP Manweb plc believe that the facts set out above are true

Signed

SP Distribution plc

SP Manweb plc

22 April 2015

⁸ “SP Energy Networks 2015-2023 Business Plan Annex: Real Price Effects 2014/15 to 2022/23”, SPEN/First Economics (January 2014) [SP1/1].