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Dear Ian

RIIO-T1 Initial Proposals: consultation response

This letter summarises National Grid Electricity and Gas Transmission's response to the Ofgem Initial Proposals consultation. It should be read alongside:

- Our detailed response to the questions set out in Ofgem's consultation, the Initial Proposal documents and associated consultants' reports, and
- The appended supplementary information papers which set out our detailed concerns on specific topics

These are complex businesses facing considerable uncertainty. In framing our original business plans, and in revising those plans in the light of comments from Ofgem, we have taken seriously our responsibility to support and evidence our plans.

Although the RIIO approach has forced us to take a much more rigorous approach to our business plan, as in previous price review processes, Initial Proposals is the first time that we have had an opportunity to test Ofgem's evidence and analysis.

The Initial Proposals give rise to a number of material issues which need to be resolved over the coming months to ensure a fair balance of cost, risk and reward for investors and consumers.

The Initial Proposals do not appear to meet the same standard of rigour or transparency that Ofgem has demanded of us. In analysing the proposals, we find numerous errors and questionable judgements which we cover in detail in our response. We welcome the engagement which we have had with you and your team since Initial Proposals which has allowed us to explore these issues in more detail, and we look forward to further constructive engagement in the run up to Final Proposals.

At this stage we would also take the opportunity to register two recent government initiatives which are likely to materially impact risk and returns for these businesses during the price control period. These new issues will need to be addressed in Final Proposals:

- DECC's 'Consultation on a proposed new power for Ofgem to compel regulated energy businesses to provide redress to consumers' – which materially affects the level of performance risk to which the business is exposed; and
- ONS's consultation to consider changes to the formulae used to construct the RPI – which is likely to rebalance a number of the careful judgements Ofgem will have made on efficient costs and returns in putting together its proposals.

Appended to this letter is an overview of a number of the key issues which are of the utmost importance to the credibility and viability of the Proposals. This is not an exhaustive list and fuller detail can be found in the supporting documentation.

Yours sincerely

A handwritten signature in black ink that reads "Pauline McCracken". The signature is written in a cursive style with a large initial 'P'.

Pauline McCracken (by email)

Cc Grant McEachran, Ofgem

Finance

Ofgem has previously recognised that it is in consumers' interests to ensure the financial package is not deficient. If the financial position of a network deteriorates, the costs of financing that business increase and could ultimately impact on its ability to invest appropriately in the network. We have two key concerns with regard to the proposed financial package:

- Ofgem's analysis of comparable risk for each network relative to the other networks / sectors and TPCR4 is inadequate
- It is not clear how Ofgem has assessed the financeability of the notional networks, especially when the Ofgem financial model contains accounting errors and does not reflect the detailed intricacies of the Proposals – such as the impact of timing of uncertainty mechanisms on cash flow. Additionally, it has only been stress tested against a narrow range of outcomes.

Comparable risk assessment

Ofgem has justified the differences in the network packages with a relative risk assessment and RORE analysis. It is clear from the information shared with us that no substantive modelling of cash flow risks has been performed by Ofgem and no robust evidence has been provided to justify the movements in asset beta implied by the proposed cost of equity and notional gearing.

In reviewing the subjective risk assessment we find that a number of important risk factors have been omitted, for example: the difference between ex ante allowances and within period determinations, and the risks associated with the System Operator activities.

In reviewing the substance of the risk assessment for the categories that are used by Ofgem we conclude that whilst we agree with the assessment in many instances, there are a large number where the assessment either double counts elements of the Initial Proposals or does not adequately reflect the detail of the Initial Proposals. Our appended detailed response includes a paper addressing our concerns with the analysis performed and updating the risk assessment to include the missing elements. In doing so, we find:

- Risk is higher under RIIO-T1 than TPCR4 for both NGET and NGGT
- NGET and NGGT to be higher risk than both SPTL and SHETL

The paper also includes a revised RORE analysis which corrects for identified errors such as:

- The omission of the SO incentives (despite including the SO RAV in the calculation and despite the lack of any ex ante return in the SO's external incentives)
- The inclusion of a Late Delivery incentive for electricity transmission which is not part of the proposed incentive package
- Double taxation of the totex incentive

From our analysis it is clear that to achieve a RORE range consistent with that of SPTL and SHETL, notional gearing would need to be reduced to 55%.

Financeability assessment

RIIO changes the way in which income is calculated and these changes may, where material, be expected to impact on the calculations performed by the various rating agencies. Ofgem has provided text in the Initial Proposals briefly describing their approach to the financeability assessment but details of the credit metric calculations and results reviewed by Ofgem have been withheld. This is despite Ofgem's previous commitment to a transparent financeability assessment and the fact that networks have previously raised a number of questions about how the metrics should be calculated.

In this context it is impossible for stakeholders to fully understand the assessment that Ofgem has performed and the basis on which they consider the Initial Proposals to meet the financeability duty.

These concerns are reinforced by the credit metrics that we have calculated ourselves for the notional networks based on the published financial model, particularly for Gas Transmission, where we do not understand the basis on which the network can be viewed as financeable against the criteria Ofgem used in their RIIO decision document.

More significantly, we have reason to believe that Ofgem has not accurately assessed how the detail of the Initial Proposals would impact on the financeability of the networks. This concern is a consequence of a number of issues, including:

- The failure to consider the actual timing of the various uncertainty mechanisms which introduce funding delays – to give a sense of quantum, for NGGT under Ofgem's 'best view' over £0.5billion of investment is incurred in the first three to four years of RIIO but not funded until 2016/17 at the earliest, once reopeners are triggered or revenue flows from uncertainty mechanisms. This naturally impacts financeability and results in charging volatility.
- The omission from the analysis of a number of other cash outflows including certain tax payments and expenditure required in RIIO-T1 to deliver outputs in RIIO-T2. Again, in order to give a sense of materiality, under Gone Green which underpins Ofgem's best view NGET would anticipate investing approximately £462m in RIIO-T1 to deliver outputs in RIIO-T2 – this investment has been excluded from the funding proposal and therefore from the financeability assessments – despite such investments being encouraged in the Ofgem RIIO handbook.
- Accounting errors which mean the financial statements in the model do not actually report the revenues, costs, debt and interest positions of the network when costs do not match allowances in a given year (which, for example, they will not when uncertainty mechanism timing delays are considered)

We are further concerned that, based both on the Initial Proposals and subsequent engagement, Ofgem's stress testing of the package is based on too narrow a range of scenarios. By way of example it did not consider possible variations in load related capex triggered through uncertainty mechanisms or alternative rates of inflation.

Overall we consider that the conclusions of the financeability assessment are unrealistic due to: the accounting errors identified subsequent to the publication of Initial Proposals; failure to adequately reflect the detailed cash-flow implications of the Initial Proposals; and, the restricted choice of scenarios. A response to these points might be that they are a set of second order concerns; however, the analysis set out in our detailed paper demonstrates that the overall impact of these factors is material.

Ofgem has invested a lot of time trying to reassure investors about the new RIIO framework. Failure to give due consideration to the needs of equity investors, and a failure to conduct the financeability assessment in a transparent and rigorous manner, risks being interpreted as Ofgem taking a somewhat complacent attitude towards financeability. Such a message would give both debt and equity investors concerns and have long term implications for the cost of capital in the sector.

ONS consultation on changes to RPI

We note the ONS consultation on possible changes to the RPI measure of inflation. These changes may be expected to introduce formula changes which would reduce the future reported rate of inflation and thereby reduce the rate at which the RAV and revenues increase. This has a profound impact on the regulated networks so we consider it necessary for the licence to include a re-opener provision such that the implications can be considered and addressed once they are fully understood. These implications are likely to be material. Investors (both debt and equity) typically require a nominal return so any reduction in the underlying return provided through price protection will need to be compensated for through a higher real return. This would require an upward adjustment to be made to both the equity return and cost of debt allowance. There are also likely to be implications for the real price effects included in cost allowances. This may need to cover both the base allowances and also the real price effects embedded in uncertainty mechanisms.

Gas Transmission

Unit costs

The analysis which provides the foundation to Ofgem's unit costs contains a number of errors and is based on unjustifiable assumptions. The unit costs for compressors and pipelines are predominantly based on feasibility study data which is an unprecedented move. The result is a set of unit costs for the construction of both pipelines and compressors which are ill-founded and unrealistic. These must be corrected in Final Proposals.

- **For pipelines:** the analysis has been based on data provided by Ofgem's engineering consultant, which is based on estimated costs from an unknown overseas location using a feasibility study for which outturn costs are not available. More complex pipelines within the feasibility study, which are typical of the level of complexity in Great Britain, have been ignored resulting in a lower unit cost being proposed. In addition, no account has been taken of historical (2006/07 – 2009/10) real price effects, which is inconsistent with the approach taken in the TPCR4 settlement. Correction of these two errors would result in a proposed unit cost which is 45% higher than that contained in Initial Proposals.
- **For compressors:** Ofgem has undertaken its own analysis using an Alaskan feasibility study which omits a number of key activities, for a project which was never built. The analysis also uses a subset of historical outturn costs from recent UK construction projects which have had all items Ofgem considers to be related to site complexity removed. The modelling therefore assumes only the most simple of scopes will be delivered in the future and takes no account of the necessary and evident complexity of our future projects. When compared to European benchmark data, the resultant unit costs are far below what has been achievable in other countries and can be expected in Great Britain.

Connections and capacity

In response to external developments and to calls from our stakeholders to align the connections and incremental capacity processes, our business plan detailed a number of developments to the regulatory framework both to deal with the implications of The Planning Act (2008) on delivering large scale infrastructure, and to ensure the gas Transmission business is financeable in light of the scale of investment envisaged during the RIIO-T1 period.

Ofgem has refrained from providing a view on the regulatory proposals in order to avoid prejudging any required commercial developments, instead proposing to roll over the current arrangements. We disagree with this approach and consider that the majority of our proposals could be implemented without any change being required to the commercial arrangements. If all changes are to wait until commercial developments have progressed, however, it is essential that Ofgem engages fully in discussions in order to allow the industry to work together and progress a solution to this industry matter in a timely manner.

In the meantime it should be noted that imposing existing obligated lead times onto capacity delivery without allowing appropriate tools to manage the risk (such as sufficient Permits and the ability to go overdrawn) potentially exposes end consumers to constraint management costs, as no network operator would be able to deliver to the obligated timescales where a Development Consent Order is required.

Further to previous communications with Ofgem on the matter, if incremental signals are received in the March 2013 QSEC auction that require NTS reinforcement that cannot be delivered within the obligated lead time, we would expect a constructive discussion on appropriate constraint management arrangements to follow.

In Final Proposals we therefore need clarity on the funding arrangements for incremental capacity to apply at the start of the RIIO-T1 period. This should include details specifying the timing of when revenues would be received, and a clear statement that the revenue drivers do not need to be included in the licence at the start of the period as they could be calculated on an 'as required' basis according to a Generic Revenue Driver Methodology based on an agreed Unit Cost Library.

Environmental legislation

There are two concerns associated with the introduction of the environmental legislation which will impact the operation of our existing compressor fleet:

- Agreement on the scope of the Directive
- The resulting impact on IQI

Agreement on the scope of the Directive

Establishing the impact of the Industrial Emissions Directive (IED), which will be transposed into UK law early in 2013, on our fleet of compressors and the extent of the works required is essential to ensure we can deliver the required changes and maintain legislative compliance. Ensuring we are appropriately funded to meet legislative compliance is a basic necessity. If meeting the UK law will require us to decommission a number of operationally critical compressor units, we have to invest to replace them.

In determining the number of affected units, Ofgem has sought to rely on an 'emergency use' clause for low utilisation units. We have sought clear unambiguous direction from an eminent QC in this field on what the UK law will require and how it will be interpreted and enforced, with particular focus on the application of this 'emergency use' clause. In short, the QC's opinions support the proposals put forwards in our business plan.

Despite the supporting legal view and given that the Directive has not yet been enacted into UK law, we are prepared to agree to Ofgem's suggestion to introduce an uncertainty mechanism (using agreed unit costs) to be triggered once the legislation has been enacted, but it is essential that the trigger for the uncertainty mechanism is appropriately defined and that it provides appropriate funding in a timely manner. Once adopted the necessary Front End Engineering Design (FEED) costs will need to be funded on an ex ante basis to ensure the replacement projects can progress in a timely manner and that the most appropriate technology is selected for each site.

To assist in providing Ofgem with more comfort on a site by site basis we have previously committed to provide Ofgem with further detail on our current expectations of the high level scope requirements for these investments. These will follow in due course.

The resulting impact on IQI

Ofgem's movement of ex ante funding (as requested in our RIIO-T1 submission) to an uncertainty mechanism creates a penalty under the Information Quality Incentive (IQI). Where it is clear that such a movement is as a result of a different legal interpretation (e.g. the scope of IED) rather than an alternative view of likely costs, it is inappropriate, inconsistent with the treatment for NGET baseline adjustments and in direct contrast to that suggested in the (Ofgem) March 2011 RIIO strategy document to assume that such a difference is 'inefficient' and that a penalty should apply in this case. We would expect this to be addressed in Final Proposals.

Pensions

The Initial Proposals do not provide any further update on the detail of the pensions deficit allocation methodology, which will determine the proportion of pension deficits funded by consumers in future years. It is vitally important that any such methodology should allocate the deficit between regulated and non-regulated businesses rather than to separately allocate scheme assets and liabilities. Separately allocating assets and liabilities would risk exposing both consumers and networks alike to unwarranted risk and volatility, particularly in the case of NGGT due to the size of the scheme.

Electricity Transmission

Policy development

A number of key elements remain undeveloped and contradictory within the Proposals, including the arrangements for assessment of network risk and the treatment of investments in RIIO-T1 which deliver outputs in RIIO-T2. Whilst subsequent discussions with Ofgem has failed to result in any further clarity, we look forward to working with you proactively on these issues in advance of the Final Proposals.

Network risk

We welcome Ofgem's confirmation that the tier 1 and tier 2 network risk assessments will be based on Network Output Measures rather than asset replacement volumes. This is more consistent with the RIIO emphasis on the delivery of outputs rather than inputs.

We remain concerned that the proposed treatment of under and over delivery does not achieve Ofgem's stated aim to expose National Grid to the risk of uncertain asset renewal volumes, and that the proposed penalties and rewards have the potential to create a conflict between our interests and those of consumers.

We also remain concerned that Ofgem's refusal to confirm the details of these proposals, for example to define the network output measures target, until the RIIO-T2 price control review will at best make these arrangements irrelevant to our RIIO-T1 asset management decisions and will at worst distort those decisions.

We have included detailed proposals in this area as part of our consultation response. There is no reason to delay development of this process to RIIO-T2 and therefore it is crucial that the arrangements are finalised as part of the RIIO-T1 control and captured in the relevant Licence Condition.

RIIO-T2 outputs

Our March 2012 business plan submission was based on the Gone Green scenario. Rather than limiting our forecast to the RIIO-T1 period, we also focussed on the longer term and considered delivery of the necessary primary outputs in RIIO-T2 such that the Gone Green scenario (which runs to 2030) could be achieved.

This is consistent with the RIIO handbook which states that: *'we expect the network companies to focus on the longer term and consider whether it is appropriate to include costs in their business plans that are related to delivery of primary outputs in future price control periods and to long-term value for money'*¹.

The handbook goes on to state that: *'Assuming the network company presents a well-justified case for including such costs in the price control for the forthcoming period, providing coherent and comprehensive evidence to support the case, we expect to include costs of this type in the price control'*.²

In the Proposals, Ofgem has disallowed our entire NGET forecast of £462m of expenditure associated with the delivery of outputs in RIIO-T2 but has not explained why. Subsequent discussions have also failed to adequately explain why this should be completely disallowed. Unlike the previous price control arrangements, there is no proposed mechanism to fund expenditure that is required in RIIO-T1 to deliver outputs in RIIO-T2. Again, Ofgem has not explained why, but has proposed that any expenditure in this category would be reviewed as part of Ofgem's assessment for the next price control on *'the principle that NGET is fully remunerated, on a cost neutral basis for the efficient costs of delivering the RIIO-T2 outputs'*³.

Ofgem further state that they *'have looked at the potential level of works for RIIO-T2 outputs that NGET might be required to start in the latter years of RIIO-T1'* and that they *'consider that the potential level of such works would be fairly modest relative to NGET's overall asset base'*. Our forecast for the Gone Green scenario is that the expenditure required in RIIO-T1 to deliver outputs in RIIO-T2 is £462m. This is over 14 times greater than the effective

¹ RIIO handbook, paragraph 6.27

² RIIO handbook, paragraph 6.28

³ 'Cost assessment and uncertainty Supporting Document', paragraph 4.35

materiality threshold that Ofgem has proposed for other uncertain costs (1% of average forecast base revenue following the application of the efficiency rate of 48% is approximately £32m). There is no explanation for these inconsistencies of approach to materiality of spend. Consequently, Ofgem *'do not anticipate this would have any significant implications for NGET in terms of its cash flow or credit ratings to warrant any measures in addition to the totex sharing factor ahead of the efficiency assessment at the next price control'*⁴. Ofgem has not provided any further details of this assessment and has not mentioned the potential impact on charging volatility.

Our preference would be for a base funding allowance for RIIO-T2 outputs, but in any case Ofgem's financeability assessment must be consistent with the proposals for this category of expenditure. Given its potential scale, it is also crucial that a mechanism to deal with this category is agreed as part of Final Proposals. We have proposed a number of competing options in our detailed consultation response and look forward to working with Ofgem to resolve this.

Capex uncertainty mechanisms

In light of the uncertainty facing NGET over the future generation and demand scenarios, the successful operation of the suite of NGET uncertainty mechanisms over the RIIO-T1 period is critical in determining the balance of risk between NGET and the consumer. Ofgem has proposed a number of changes to those proposed in our business plan. The appended paper outlines the concerns we have with the simplified approach Ofgem is proposing.

For example, Ofgem has proposed a revised local generation uncertainty mechanism on the basis that it is a simpler, more accurate version. Ofgem have since conceded that their approach is less accurate, but we continue to be concerned that the analysis on which the conclusion was based is systematic of an overly simple approach. For example, it was based on the consideration of only three scenarios and ignored the impact of a number of critical aspects (for example, changes in demand and embedded generation and spend in RIIO-T1 that delivers outputs in RIIO-T2).

Whilst we understand the need for arrangements which are as simple and transparent as possible, it is essential that proposals are fully tested using probabilistic analysis. We have developed further proposals in this area which aim to address the issue of complexity without compromising accuracy, thus mitigating the risk of windfall gains or losses for National Grid or consumers. Details of these proposals are included in the main body of our response and we look forward to working with Ofgem on these.

The Ofgem analysis contains errors which materially impact the quality of the assessment - for example Construction efficiency assessment

In developing their Proposals, Ofgem has included additional efficiency savings of approximately £765m on our 'baseline' expenditure based on Ofgem's assessment of their engineering consultants' benchmarking. These are in addition to the construction efficiencies which were already embedded into our plan.

We have reservations regarding the quality of the consultants' analysis. These concerns can be summarised under two main headings:

- **Errors** – the analysis contains a number of mistakes and inconsistencies. For example:
 - The consultants do not differentiate between GIS and AIS high voltage switchgear costs. This is counter to previous discussions with Ofgem, external benchmarks and benchmark data provided by Ofgem as part of the TPCR4 Rollover process.
 - The consultants' comparisons with historical unit costs do not appear to take account of changes of definition since TPCR4 and the roll over year, and in the case of switchgear units they have applied incorrect volume weightings to AIS and GIS switchgear to produce misrepresentative comparisons.
 - There are inconsistencies between the bottom-up assessment of scheme costs and the 'Ofgem level' unit cost comparisons for the same schemes.

⁴ Cost assessment and uncertainty Supporting Document, paragraph 4.37

- **Poor process** – the benchmarking approach adopted does not meet Ofgem’s own stated requirements for transparency and robustness and fails to meet best practise. This view has been independently verified by Professor Tom Weyman-Jones of Loughborough University⁵. For example:
 - By far the largest reduction is switchgear ‘lead asset’ spend. In Poyry’s bottom-up analysis of non-load related schemes, they did not review a single circuit breaker replacement scheme; circuit breaker replacement makes up over £700m (or 60%) of our non-load related forecast expenditure in the switchgear category.
 - In order to benchmark, it is absolutely essential that costs are compared for the same scope (equipment and activities). We know from a preliminary meeting in March 2011 that there was significant variation in interpretation between ourselves, both Scottish TOs and the consultants. Given the wide range in reported costs and discussions during cost visits, we still have concerns around the consistent definition of scope.
 - The bottom-up assessment of scheme costs is far from transparent. Consultant costs are only provided for a subset of units, and there is then a balancing figure to get to their total scheme estimate which is not explained at all.
 - Due to the different nature and size of the three TOs’ networks, there are many units for which the Scottish TOs have not provided a cost and, even where they have, the different scale of business plans mean that these might be based on statistically-insignificant sample sizes (or, in one case, no projects at all).

Ofgem has taken the consultants’ flawed benchmarks and applied them as cost efficiency adjustments against the NGET submission. In doing this Ofgem has used a scenario for load-related transformer projects and the majority of non-load related projects which ignores the construction efficiency which we had already built into our business plan, thus effectively double counting the efficiency.

Based on the issues raised above, we challenge the starting values and application of the consultants’ benchmarks. The impact of the shortcomings in the analysis should be considered in the development of the Final Proposals.

The Ofgem analysis contains errors which impact the quality of the assessment - for example opex assessment

The NGET opex assessment separately reviews the constituent activities with little or no regard to interactions with capex, other opex activities or the deliverability of the resulting allowances overall. This assessment is both based on errors and results in unachievable targets which focus on cost reduction rather than considering the outputs delivered or totex benefits of the expenditure.

The application of 1.25% per annum catch up efficiencies based on TPCR4 performance against allowances has no basis and does not take account of benchmarking evidence which shows we both improved our cost efficiency during the TPCR4 period and are in the upper quartile for cost efficiency.

Efficiencies are double counted in the calculation for direct opex, incorrect assumptions have been applied by assuming perfect linearity between opex and capex.

Whilst individually the impact of each of these errors could be considered to be of a lower magnitude; cumulatively they are material and the result is a set of allowances which are divorced from reality and a departure from RIIO principles. RIIO guidance was to consider planned expenditure as a whole; these proposals appear to revert to RPI-X principles when the result of this assessment is an increased opex requirement.

⁵ A report outlining the review of Ofgem’s benchmarking is appended to the detailed Consultation response as a supporting information document

Joint Electricity and Gas

Business support benchmarking

If costs are adequately normalised and the methods used are applied consistently, the use of cross network benchmarking for business support costs is a valid assessment method. The issue with the use of such benchmarking in the Initial Proposals is that neither of these conditions has been fully adhered to, giving rise to logic flaws in the methodology used.

There are several examples of such errors which we outline within the detail of our response; at the highest level the two which give us the most concern are that:

- Costs have currently been benchmarked based on 2010/11 metrics such as FTEs or revenue, rather than considering the impact of increases in these metrics over the RIIO-T1 period due to growth or catch-up efficiencies which will take place before RIIO-T1 begins.
- The use of efficiency additions based on the strength of benchmarking and market testing in the business plans is a good inclusion in the methodology. Currently, however, much of the evidence included as part of our RIIO-T1 submission has been ignored in this calculation.

These errors, and the others outlined in our response, mean that the applicability of the assessment to the RIIO-T1 period as it stands is very questionable. Without adjustment the methodology does not give an accurate, balanced assessment of the costs in this area

Real pay assumptions

Within our submission we differentiated pay growth between our Gas Distribution and Transmission networks by giving evidence for a higher rate of pay growth reflecting the more specialist nature of staff within critical Transmission roles. Such growth was reflected in the RIIO-T1 fast track outcomes and was included within long-term pay growth assumptions for DPCR5, but has not been included within the Initial Proposals for NGET or NGGT.

The Initial Proposals instead place real pay growth in NGET and NGGT at the same level as in Gas Distribution, rather than the inherently closer industries of the Scottish TOs and Electricity DNOs. This differential in pay growth gives rise to worrying incentives for our staff and creates an artificial market impact that will influence the fluid resource market between the three industries. The BEAMA index for electrical engineers used by the DNOs and Scottish TOs as evidence for the specialist premium has seemingly been ignored in the assessment of pay growth for our Initial Proposals and we would expect this to be addressed in the Final Proposals.

SO capex detracting from the ability to manage the network for least cost in the future

Initial Proposals disallow the majority of SO capability enhancements which will be required in the latter half of the RIIO-T1 period to efficiently operate the Transmission networks. As the UK energy sector decarbonises and demand side volatility grows, energy flows will necessarily change on the networks. This, coupled with significant regulatory change as a result of the European Third Energy Package, drives the need for new and enhanced capabilities within the SO. Without these investments, balancing and constraint costs will increase significantly, far outweighing the proposed investment costs.

Stakeholders have repeatedly confirmed that these investments are required and have encouraged us to invest in the capability earlier rather than later.

Ofgem's consultants, however, proposed that rather than funding these enhancements on an ex ante basis, an uncertainty mechanism should be created to ensure the need case is valid prior to the provision of funding. Initial Proposals have removed the ex ante funding and do not include such a mechanism. Without the corresponding uncertainty mechanism to ensure the required funding can be made available in a timely manner, Initial Proposals do not incentivise us to develop those capabilities, which cannot be the right answer for the consumer. This position could easily be rectified by including a specific uncertainty mechanism for SO costs, based around a mid-period assessment of the need case.