

RIIO GD1 - UNCERTAINTY MECHANISMS

CHAPTER 2 - Proposed approach to managing uncertainty

Question 1: Are there any additional criteria that we should take into account to guide the appropriate use of uncertainty mechanisms?

No.

Question 2: Do you agree with the information requirements that we set out to support the justification of additional uncertainty mechanisms? If not, what changes should we make to these requirements?

The proposed information requirements set out in table 2.2 appear to be appropriate.

CHAPTER 3 – Potential uncertainty mechanisms for all sectors

Question 1: Do you think there should be a change to a 12-month average approach to RPI indexation of allowed revenues? If there were a change to a 12-month average approach, would there need to be any transitional adjustments?

NGN supports moving to a January to December 12 month average indexation approach for allowed revenues. This approach has the following advantages;

- A 12 month average approach will reflect all price movements over a given period, unlike a 6 month average, which would miss any price movements for the 6 months not considered.
- Using January to December averages enables the revenue indexation to use a full year of actual data, whereas April to March averages would require an estimate of the index for January to March which;
 - Could be open to interpretation; and
 - Would not necessarily be the same for all industry participants. This could be reconciled in the following years price change, but this adds an extra unnecessary variable into the price setting process.

The only potential disadvantage of using January to December averages is that, when compared to April to March averages, it backdates the impact of RPI growth when setting the next years allowed revenues. However this is unlikely to be material, and given the nature of an index, any variance in one year will likely be offset the following year. The only exception to this would be where one years real base revenue was materially different to the following years, but this is not considered to be a material concern.

NGN do not see any necessity for a transitional arrangement. Assuming the base year prices used for the next price control are 2009/10 prices, the base for indexation would be January to December 2009 average RPI, as opposed to July to December RPI under the current 6 month methodology. Any transition would only be necessary if there was a material movement in prices in the January to June index leading to a materially different RPI for January to December when compared to the July to December index. In reality;

- 2009 July to December RPI = -0.4%
- 2009 January to December RPI = -0.5% (as the January to June RPI = -0.66%)

This would suggest a less than 0.1% difference, which is considered immaterial.

Question 2: Do you have any views on the design of the reopener for the introduction of Traffic Management Act permitting schemes? In particular, is the timing of the reopener window appropriate

and what approach should we adopt to set the materiality threshold before it can be triggered? Do you agree with our proposal that the reopener would only apply in gas distribution?

We agree with the principle of a reopener for unavoidable NRSWA / TMA costs and support the use of a materiality threshold that a DN could use to trigger such a reopener.

We believe that, as in GDPCR, there should not be a fixed window but that a GDN should be able to trigger a reopener once the materiality threshold has been breached (subject to the availability of at least six months of cost data). This is because TMA implementation is being done on ad-hoc basis by the various highway authorities which will result in the trigger being reached at very different times across the country.

If a reopener is triggered then the GDN should have the opportunity to provide details of costs not just for schemes already in place but also forecast costs for proposed schemes with a high level of certainty that they will progress before the end of the control.

We strongly urge Ofgem to include the costs associated with possible Lane Rental schemes within the materiality threshold. Although no schemes are yet in place it is clear that, if and when introduced, these costs would be equally unavoidable and of at least the same magnitude as permitry costs.

We have no view as to whether or not the reopener should apply more broadly than gas distribution.

Question 3: Do you have any views on the design of the mechanism for changes in the requirements required by the Centre for the Protection of National Infrastructure? As above, is the timing of the reopener window appropriate and what approach should we adopt to set the materiality threshold before it can be triggered?

With the possibility of DECC reviewing critical NI locations and the statement within The Strategic Defence and Security Review that there should be a review of the policing strategies at CNI sites. The impact upon the network could increase significantly with both up scaling security positions and on-going Opex costs. With this being a long term and permanent impact probably with phased implementations across sites then the 12 month review would fit which would use a multiple types of uncertainty mechanism as described in Table 5 of Section 11.11 of the RIIO document

Question 4: Are there any additional mechanisms that we should be considering? If so, how should these be designed?

At a generic level no. Though some consideration needs to be given as to how the potential impact of smart metering on the emergency service is being dealt with. We note the suggestion that this should be incorporated into our business plan. To this end some analysis is being done through the ENA on the percentage of installations that could trigger additional work. Our business plan will seek to indicate the impact on costs. Given the smart metering roll out will not have commenced by the time of business plan submission these forecasts will be unproven and untested. Both Ofgem and the companies may therefore wish to consider the use of uncertainty mechanism in this area at a future point in the review.

Question 5: Do you agree with our proposal to leave the disapplication arrangements unchanged?

Yes.

Question 6: Do you have any views on the other mechanisms discussed in this chapter?

No.

CHAPTER 4 – Potential gas distribution uncertainty mechanisms

Question 1: Do you have any views on our proposed approach to managing uncertainty around connections volumes?

We agree with the proposed approach of basing allowances on ex-ante assumptions of the level of connections activity.

Question 2: Do you agree with our proposal to remove the loss of meter work revenue driver? If not, why do you think retaining the mechanism is in the consumer interest?

NGN is the only GDN that does not have external contracts for domestic meter work following the decision by National Grid Metering to award the contracts to an alternative contractor in the current price control. As can be seen from the data published by Ofgem this led to a significant increase in the operating costs of our emergency service. However, this data does not show the full impact as it excludes costs associated with a programme of staff reduction nor increased costs in areas where emergency staff are undertaking work previously carried out by contractors, e.g. purge and relight activities. Ofgem needs to factor these costs into its analysis of performance against the loss of meter work revenue driver before making judgements on the relative performance against the driver. Based on our experience the existing revenue driver does not fully compensate for the increased costs and therefore has not led to the levels of outperformance shown in figures 5.4 and 5.5.

We believe the existing revenue driver does place the right incentives on GDNs and was not a factor that impacted on our commercial approach to bidding for this work which was done on a full market rate basis with no cross subsidisation applied. There are developments in the metering market notably the entry of new competitive providers and more demanding customer requirements that mean GDNs are increasingly unlikely to obtain such contracts using emergency staff who's priority will always be emergency work.

It is in customers interest that the GDNs maintain an efficient and effective emergency service and that companies like NGN who have taken significant steps to reduce the impact of the loss of meter work on the cost to customers by setting performance targets that will be used to benchmark other companies are not penalised. If Ofgem is minded to remove the specific revenue meter work driver then it is essential that NGN obtains broadly equivalent allowances for its emergency service as it currently receives under the existing price control including the meter work revenue driver.

Question 3: Are there any additional mechanisms that we should be considering? If so, how should these be designed?

At this stage we have no further proposals but when there is a clearer picture of the output and incentive calibrations this question needs to be re-considered particularly in relation to how uncertainty caused by events outside the control of GDN are dealt with.

However, there are two existing provisions within the current gas distribution licence which probably fall under the heading of uncertainty mechanisms that have not been considered here. These are set out below includes our comments on the future application:

- Third Party Water Ingress Adjustment. This allows recovery of 95% of the costs of supply restoration payments above a threshold value of 1.5% of allowed revenue. The current arrangements still expose the GDNs to significant penalties for major incidents caused by events outside of their control and even above the threshold value still expose the GDN to costs. We believe the current arrangements provide the right balance in incentivising GDN behaviour to extreme events whilst capping the overall exposure to events beyond their control.
- Exit income adjusting event (IE). This limits GDN exposure to increase in exit capacity costs to 0.5% of allowed revenue arising from force majeure events under network code or declaration of network gas supply emergency. Given the policy around offtake capacity arrangements is being reviewed and is likely to change it is too early to determine whether this provision should continue in its existing form.

Question 4: Do you agree with our proposal to leave the disapplication arrangements unchanged?

Yes we are supportive of this position.

Question 5: Do you have any views on the other mechanisms discussed in this chapter?

Not at this stage.

CHAPTER 5 – Potential gas transmission uncertainty mechanisms

Question 1: Do you agree that it is appropriate to continue to use an uncertainty mechanism for delivering entry and exit capacity in gas transmission, and do you agree that revenue drivers are the most appropriate uncertainty mechanism?

Existing revenue drivers adjust for incremental entry and exit capacity. To introduce, as an alternative, the requirement to include a forecast expenditure over an eight year or even a four year horizon would expose the consumer to forecasting uncertainty and would potentially be a retrograde step.

Question 2: If you think that a different mechanism could be more suitable, do you have any views on how such a mechanism could operate?

Current mechanisms provided a satisfactory approach and should be retained.

Question 3: Do you agree that our proposals will properly align the mechanism with the RIIO framework?

Yes, this is consistent with Ofgem's approach to RIIO-GD1 and the RIIO framework.

Question 4: Do you have any views on changes to the operation of revenue drivers if there are delays on the user side?

Note. UNC332 replaced by UNC0350.

The use of demonstration information to give NGG confidence that an incremental capacity change is accommodated is not unreasonable. However, the risk is simply being moved from NGG to the GDN's. Consequently, there must be a process to mitigate the costs incurred by the GDN's when developing the need for incremental capacity, when that need is subsequently cancelled.

Question 5: Do you have any views on the process that would be used to set the value of revenue drivers at specific entry or exit points?

NG Transmission issue but approach seems reasonable.

CHAPTER 6 – Potential electricity transmission uncertainty mechanisms

Question 1: Do you think that an uncertainty mechanism for electricity transmission connections expenditure is likely to be in consumers' interests?

N/A - Question applicable only to electricity transmission companies.

Question 2: Do you have any views on future connections projects (number of projects, costs, etc.), and the uncertainty around these numbers?

N/A - Question applicable only to electricity transmission companies.

Question 3: Do you agree that volume drivers are the preferred option, and do you have any views on how they should be designed?

N/A - Question applicable only to electricity transmission companies.

Question 4: Are any other uncertainty mechanisms needed for connections expenditure? If so, how should these be designed?

N/A - Question applicable only to electricity transmission companies.

Question 5: Do you have any views on the option of setting upfront revenue allowances, during the price control period, for qualifying high-cost connections projects?

N/A - Question applicable only to electricity transmission companies.

Question 6: Do you have any views on the uncertainty mechanisms that we have proposed for wider reinforcement works?

N/A - Question applicable only to electricity transmission companies.

Question 7: Do you have any views on the treatment of Inter-TSO costs?

N/A - Question applicable only to electricity transmission companies.

CHAPTER 7 – Mid-period review of output requirements

Question 1: Do you agree with the scope of the mid-period review? If not, what changes to the scope are needed?

Yes.

Question 2: Do you agree with the indicative process and timetable? If not, how could the process and timetable be improved?

Yes.

Question 3: Do you have views on when we should make licence changes as a result of any actions taken at the mid-period review? If a threshold to make a licence change is seen as appropriate, what should this be?

Licence changes should be drafted and consulted upon before a final decision is made to implement a policy change so that all parties are clear as to the nature of the change. As per the indicative timetable nine months prior to implementation would appear a reasonable period to begin this process.

It is very difficult to specify a threshold value at this point when it is not clear what level of detail will be included within the licence in relation to the output measures. Good practice would suggest any changes should be implemented through licence modification as this affords the necessary rights upon affected parties.