Consultation on Ofgem minded-to position for the review of costs associated with the TPCR4 enhanced physical security upgrade programme and the RIIO-T1 and RIIO-GD1 enhanced physical site security uncertainty mechanisms

We are unable to comment on questions 1 to 3 of the consultation insofar as they relate more specifically to the costs that you have assessed for the proposed revisions to allowances. However, we have concerns relating to transparency and the recovery profile of the requested costs.

RIIO T1 EPSS reopener

Whilst we accept that the adjustments are relatively small for RIIO-T1 Enhanced Physical Site Security (EPSS) we believe that NGET and NGGT could have and should have done more to flag the potential magnitude of the EPSS revenue adjustments.

RIIO-GD1- EPSS reopener

We are more concerned in respect of the RIIO-GD1 EPSS reopener in that some of the proposed adjustments are material and we believe the GDNs have had regular opportunities to make the industry aware of the forthcoming change to charges.

Background

The amounts of funding that the GDNs have applied to recover through the May 2015 reopener window are significantly higher than the amounts that they published in their quarterly Modification 186 (MOD186)[1] reports. If successful, these applications will result in significant adjustments to several GDNs' allowed revenues in the formula years commencing April 2016 and April 2017.

E.ON UK is interested in the RIIO-GD1 revenue adjustments proposed in this consultation because they have a direct impact on the GDNs' future allowed revenues and, by extension, on their future gas distribution charges. In order to ensure that we are pricing gas distribution costs into our tariffs/contracts at the right level, we closely monitor potential future increases/decreases to the GDNs'

[1]The GDNs produce their own five-year forecasts of annual allowed revenues every quarter – these are known as MOD186 reports and break down the total allowed revenues into their individual components, e.g. uncertain costs which are subject to reopeners.

allowed revenues and we rely on the GDNs providing us with the latest and most accurate information that is available to them. If the GDNs fail to do so, consumers can be detrimentally impacted.

Lack of transparency

Modification 186 which was introduced in 2008 was intended to facilitate suppliers and shippers having better access to information which would enable them to more accurately forecast changes in transportation charges, thereby reducing uncertainty and risk and leading to more confident planning of future charges. The publication and discussion of the MOD186 reports at the Distribution Charging Methodology Forum (DCMF) meeting provides an opportunity for Transporters to engage and inform stakeholders of forecast costs for a period up to 5 years ahead. The GDNs have a clearly defined mechanism for publishing their latest best views on uncertain costs; there are specific sections within Table 6 of the GDNs' MOD186 reports where this cost information can be entered and E.ON feels that the GDNs should have provided stakeholders with more timely and accurate notice regarding the revenue adjustments that they applied for in the May 2015 application window.

Since late 2014 we have been using the quarterly DMCF to actively engage with the GDNs regarding the Enhanced Physical Site Security (EPSS) reopener. At the October 2014 DCMF, David Chalmers of National Grid Gas Distribution (NGGD) clarified that the EPSS costs figures that NGGD had published in Table 6 of their MOD186 reports represented the "latest view of the maximum impact of these 'uncertain costs'".[2]

At the same meeting, it was highlighted that the other three GDNs had not populated the EPSS rows of their MOD186 reports. A representative of RWE npower "referred to Table 6 blank rows and asked if a maximum value of elements or timings could be provided by the DNs".[3] An action was opened for the "DNs to ascertain whether values (preferably maximum) could be provided across blank rows."

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[2] See section 2.1 of the meeting minutes - http://www.gasgovernance.co.uk/sites/default/files/Minutes%20DCMF%20291014%20v1.0.pdf

[3] See section 2.2 of the meeting minutes (see link provided in footnote 2).

Although this topic was raised several times in subsequent meetings, the GDNs did not make any adjustments to the values contained within their MOD186 reports.

In summary:

1. SGN did not include any figures for uncertain costs in any of its MOD186 reports right up until July 2015 (even after it had submitted its reopener application to Ofgem); and
2. NGGD has not updated its view on EPSS impacts since July 2014.

We trust that the above shortcomings are primarily due to issues with the GDNs' internal reporting processes.

Disparity between the revenue adjustments requested in the application window and the figures published in the GDNs' MOD186 reports

We recognise that there is inherent uncertainty in these kinds of costs and that it can be difficult to accurately forecast outturn amounts. As a result, we would not have expected the figures that the GDNs include in their MOD186 reports to exactly match the amounts that they applied for in the May 2015 window. Nevertheless, we have an expectation that the GDNs will endeavour to populate the relevant cells in the MOD186 reports and will update reports with the latest information available to them. Section 5.13.1 (c) of the Transportation Principal Document of the UNC states that the cost information contained in the quarterly MOD186 reports shall be "reasonably determined by the DN Operator on an accruals basis (based on such information as is reasonably available to it at the relevant time[4])". We do not feel that the GDNs have fulfilled their UNC obligation in this regard.

The period of time over which the work was planned and the information was gathered for the purposes of the Harnser Group audits was prior to the price control reopener applications. This should have given the GDNs an opportunity to provide a reasonable assessment of the expected costs that would have formed the basis of

44 http://www.gasgovernance.co.uk/sites/default/files/Transportation%20Principal%20Document%20(Consolidated,%20printable%20version).pdf

the reopener applications and provide information to the industry in terms of the MOD186 reports.

Scotia Gas Networks

Scotia Gas Networks (SGN) did not include any figures for expected EPSS revenue adjustments in any of its MOD186 reports right up until July 2015 (after it had submitted its reopener application to Ofgem). At the very least, some indicative figures should have been available for the April reports.

Revenue impacts of amounts in April 2015 MOD186 reports (14/15 prices)

EPSS		**2015/16**	**2016/17**	**2017/18**	**2018/19**	**2019/20**	**2020/21**	**TOTAL**
Scotia	Scotland	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Scotia	Southern	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Total		**0.00**	**0.00**	**0.00**	**0.00**	**0.00**	**0.00**	**0.00**

If SGN is awarded the full amount that it applied for in the May 2015 application window, this will result in a £43.79m revenue adjustment over the final five years of the RIIO-GD1 price control.

Revenue impacts of amounts asked for via reopener (14/15 prices)

EPSS		**2015/16**	**2016/17**	**2017/18**	**2018/19**	**2019/20**	**2020/21**	**TOTAL**
SGN	Scotland	0.00	14.08	0.07	0.15	0.23	0.28	14.81
SGN	Southern	0.00	18.09	4.68	5.38	0.35	0.48	28.98
Total		**0.00**	**32.17**	**4.75**	**5.53**	**0.58**	**0.76**	**43.79**

National Grid Gas Distribution

In contrast to SGN, NGGD has been publishing information regarding potential EPSS revenue impacts its MOD186 reports. In its July 2015 MOD186 report, NGGD's latest view of the total maximum impact of these uncertain costs across all four of its networks was £41.97m.

EPSS		**2015/16**	**2016/17**	**2017/18**	**2018/19**	**2019/20**	**2020/21**	**TOTAL**
NGGD	EoE	0.00	0.30	9.08	6.85	0.82	0.00	17.05
NGGD	Ldn	0.00	0.20	3.05	0.89	0.20	0.20	4.54

NGGD	NW	0.00	9.41	0.49	0.47	0.46	0.46	11.29
NGGD	WM	0.00	0.56	6.79	1.05	0.35	0.35	9.09
Total		**0.00**	**10.47**	**19.41**	**9.25**	**1.83**	**1.01**	**41.97**

If NGGD is awarded the full amount that it applied for in the May 2015 application window, this will result in a £66.65m revenue adjustment over the final five years of the RIIO-GD1 price control.

Revenue impacts of amounts asked for via reopener (14/15 prices)

EPSS		**2015/16**	**2016/17**	**2017/18**	**2018/19**	**2019/20**	**2020/21**	**TOTAL**
NGGD	EoE	0.00	2.63	16.20	12.34	2.50	0.39	34.06
NGGD	Ldn	0.00	2.18	9.25	5.03	1.83	0.21	18.50
NGGD	NW	0.00	7.78	2.17	2.97	0.74	0.43	14.09
NGGD	WM	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Total		**0.00**	**12.59**	**27.62**	**20.34**	**5.07**	**1.03**	**66.65**

In itself, it is not necessarily concerning that the amounts that NGGD applied for in the May 2015 application window are significantly higher than the 'maximum potential impacts' that they included in their MOD186 reports – we recognise that there is inherent uncertainty in these costs and that it can be difficult to accurately forecast outturn amounts.

However, we are disappointed that the EPSS figures included in NGGD's MOD186 reports have not changed since July 2014 – we would have expected NGGD's ability to accurately estimate these costs to have improved substantially as the May 2015 application window approached. In particular, it is worth noting that NGGD did not update its view on EPSS impacts in its July 2015 MOD186 reports, even though it had already submitted its May 2015 reopener application to Ofgem by this point.

Recovery profiles of EPSS costs

Suppliers are interested in adjustments to the GDNs' allowed revenues because they can have significant impacts on gas distribution charges, and therefore customer costs. Adjustments to allowed revenues over the short and medium term (i.e. the formula years commencing April 2016 and April 2017) can be particularly concerning because many suppliers have large numbers of customers on fixed tariffs and contracts.

The table below shows that the majority of the requested revenue adjustments would impact allowed revenues in the formula years commencing April 2016 and April 2017.

Revenue impacts of amounts asked for via reopener (14/15 prices)			
£m	**Total impact over the remainder of RIIO-GD1 (£m)**	**Impact in formula years commencing April 16 & 17 (£m)**	**% of impact in formula years commencing April 16 & 17**
SGN	43.79	36.92	84%
NGGD	66.65	40.21	60%

The potential impact on charges is more pronounced in some gas distribution regions than others. For example, according to SGN analysis,[5] the requested adjustment to the 2016/17 allowed revenues of its Scottish region could have a +3.8% impact on its April 2016 gas distribution charges. Given that SGN only notified suppliers of the magnitude of the potential revenue adjustment in July 2015, the associated increase to charges could potentially leave suppliers unable to reflect these charges through to customers on fixed tariffs and contracts.

We note that the period of time between the applications for price control reopeners and the period from when these costs would then begin to be recovered gives suppliers little time to prepare to apply the revised charges to their contracts and tariffs. We therefore propose that the impacts of the reopeners should be effective from April 2017 onwards, instead of from April 2016 onwards. This would be consistent with the two year lag which applies to incentives revenues within the RIIO price controls.

Impact on consumer tariffs/contracts

The lack of predictability in network charges can ultimately have detrimental impacts on consumers. For example, if suppliers perceive that there is a lack of transparency in the cost information being published by the GDNs; this may result in increased risk premia being priced into tariffs and contracts. Although substantial

[5]See Scotia Gas Networks – Southern MOD186 report: http://www.gasgovernance.co.uk/0186reports/2015jul

progress has been made in this area through modifications in recent years, there is still clearly room for improvement.

Q4. Do you agree with our proposal to introduce an output commitment in relation to enhanced physical security?

Yes we support the requirement for all network companies to take the necessary and proportionate action to ensure that any site designated as CNI are compliant as required by DECC by the end of the price control period.

Conclusion

In order to accurately price network costs into our tariffs and contracts, we rely on the network companies providing us with the latest costs information that is available to them. If they fail to do so, consumers can be detrimentally impacted.

We note that the amounts of funding that the GDNs have applied to recover through the May 2015 EPSS reopener window are significantly higher than the amounts that they published in their quarterly MOD186 reports. Given that EPSS planning and information gathering was being carried out well in advance of the reopener window, we believe that the GDNs could have provided us with greater foresight of the requested revenue adjustments.

We propose that the impacts of the reopeners should be effective from April 2017 onwards, instead of from April 2016 onwards. We also request that, in future, all of the network companies do more to ensure that stakeholders are being provided with the latest costs information as this becomes