

Mid-period review: Statutory Consultation on modifications to the RIIO-ET1 & RIIO-GT1 PCFMs to incorporate the MPR

Consultation

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Contact: Matthew Brown, Senior Manager

Team: RIIO Finance

Tel: 020 7901 1835

Email: matthew.brown@ofgem.gov.uk
mpr@ofgem.gov.uk

Overview:

The RIIO-T1 price control provides for a mid-period review of output requirements.

In February 2017, we decided to reduce National Grid Gas Transmission's allowances by £168.78m, to reduce National Grid Electricity Transmission's allowances by £38.12m and increase National Grid Electricity System Operators allowances by £21.51m.

This consultation sets out the modifications needed to the financial models to revise the relevant allowances. The impact of these reductions will first flow into revenue for 2018/19 as part of the 2017 Annual Iteration Process (AIP).

All values are in £m 2009/10 Prices unless otherwise stated and quoted to 2 decimal places.

Context

RIIO-T1 and GD1 were the first price controls to reflect the RIIO (Revenue = Incentives + Innovation + Outputs) model. The RIIO-T1 price control sets the outputs that the electricity and gas transmission network companies need to deliver for consumers and the associated revenues. Similarly, the RIIO-GD1 price control sets these for gas distribution companies. We have also launched the RIIO-ED1 price control for electricity distribution, which runs on a different timetable.

The RIIO framework is designed to promote smarter gas and electricity networks for a low carbon future. RIIO price controls emphasise incentives to drive the innovation needed to deliver a sustainable energy network that offers value for money to existing and future consumers. The RIIO framework allows for a mid-period review (MPR) of outputs halfway through the price control.

In May 2016, we published our decision to launch an MPR for certain areas of the RIIO-T1 price control for National Grid Electricity Transmission and National Grid Gas Transmission.

In February 2017 we set out our decision to change outputs and funding. We are now consulting on the changes to the Price Control Financial Models required to implement that decision.

Associated documents

- RIIO-T1: Final Proposals for National Grid Electricity Transmission and National Grid Gas – Overview *and* Cost Assessment and Uncertainty Supporting Document <https://www.ofgem.gov.uk/publications-and-updates/riio-t1-final-proposals-national-grid-electricity-transmission-and-national-grid-gas-%E2%80%93-overview>
- Decision on a mid-period review for RIIO-T1 and GD1 <https://www.ofgem.gov.uk/publications-and-updates/decision-mid-period-review-riio-t1-and-gd1>
- Consultation on the mid-period review of RIIO-T1 <https://www.ofgem.gov.uk/publications-and-updates/consultation-mid-period-review-riio-t1>
- Mid-period review decision <https://www.ofgem.gov.uk/publications-and-updates/mid-period-review-decision>

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Executive Summary

The RIIO-T1 price control provides for a mid-period review (MPR) of output requirements. In May 2016 we decided to launch an MPR for RIIO-T1 and look at certain outputs for National Grid Electricity Transmission and National Grid Gas Transmission.

In February we decided to remove National Grid Gas Transmission's Avonmouth pipelines output and £168.78 million in funding, as the pipelines are no longer required. We have also decided to reduce National Grid Electricity Transmission's allowances by £16.61 million. This reflects a reduced requirement to protect sites against rising fault levels (lowering allowances by £38.12 million) and new activities relating to the new enhanced system operator role (increasing allowances by £21.51 million).

This Statutory Consultation sets out the proposed modifications to the respective Price Control Financial Models (PCFMs) to revise these allowances. We proposed to do this by adjusting the relevant totex subcategories outlined in the MPR decision.

We also propose to add additional inputs to maintain the original Final Proposals profile of IQI ex-ante rewards and penalties the companies face to avoid unnecessary volatility in revenues allowed to be recovered.

There will be no revenue impacts of these changes until we carry out the Annual Iteration Process (AIP) by 30th November 2017. The impacts will flow into the MOD_t term for regulatory year 2018/19 and in subsequent years.

All values are in £m 2009/10 Prices unless otherwise stated and quoted to 2 decimal places.

1. Background to the mid-period review and prior decisions

Decision revising allowances from the mid-period review

1.1. Our February 2017 decision¹ on the mid-period review is composed of three parts:

- a) **National Grid Electricity Transmission's (NGET) outputs**
We decided to reduce the fault levels output and lower allowances by £38.12m and to make no change to the shunt reactors output.
- b) **NGET's new enhanced system operator (SO) outputs**
We decided to provide a total of £21.51m additional funding for the Integrated Transmission Planning and Regulation (ITPR), new Balancing Services and Demand Side Response activities.
- c) **National Grid Gas Transmission's (NGGT) Avonmouth pipelines output**
We decided to remove the Avonmouth pipelines output and reduce allowances by the £168.78m.

1.2. The full reasoning behind these adjustments can be found in the mid-period review decision document.

Decision to use a Statutory Consultation for modifications

1.3. The Price Control Financial Models (PCFMs) are defined as Price Control Financial Instruments under *Special Condition 5A. Governance of ET1 Price Control Financial Instruments* of the electricity transmission licence and *Special Condition 4A. Governance of GT1 Price Control Financial Instruments* of the gas transporter licence.

1.4. These conditions establish a change control framework which allows for self-modification of the Instruments where the impact of changes are considered non-significant.

¹ https://www.ofgem.gov.uk/system/files/docs/2017/02/mid-period_review_decision.pdf

1.5. However, we consider the changes to non-variant allowances, as described in section 2, to constitute a significant impact. We have therefore decided to use a full Statutory Consultation for the proposed changes.

1.6. We have also convened the relevant PCFM Working Groups², as defined in each sectors Price Control Financial Handbook Chapter 1, prior to this consultation. The groups agreed that the proposed modifications should be considered significant.

Model references throughout this document

1.7. Where references are given to positions in the excel workbooks, these refer to the most recent version of the PCFM at the time of this publication. These are the two PCFMs published on 30th November 2016, following the 2016 Annual Iteration Process.³

1.8. Throughout this document both row references and row labels are given. Subsequent revisions to the PCFM may mean that these row references become outdated. In the case of disagreement, row labels should take precedent.

² An industry expert working group made up of representatives from Ofgem and the relevant licensee's.

³ For RIIO-ET1 this is model named ET1 PCFM November 2016 (available at <https://www.ofgem.gov.uk/publications-and-updates/riio-et1-financial-model-following-annual-iteration-process-2016>) and for RIIO-GT1 this is GT1 PCFM November 2016 (<https://www.ofgem.gov.uk/network-regulation-riio-model/price-controls-financial-model-pcfm/riio-t1-financial-model-gas>).

2. Modifications to the Price Control Financial Models

Question 1: Do you agree that the proposed modifications to the RIIO-ET1 PCFM appropriately incorporate the MPR decision?

Question 2: Do you agree that the proposed modifications to the RIIO-GT1 PCFM appropriately incorporate the MPR decision?

Maintaining the profile of IQI ex-ante rewards and penalties

2.1. At the time of Final Proposals, we awarded each company an ex-ante reward or penalty as part of the Information Quality Incentive (IQI) mechanism⁴, to incentivise high quality business plans. NGET was given an £100.24m ex-ante reward while NGGT was given an -£13.05m ex-ante penalty following our assessment of their business plans.

2.2. To avoid undue volatility in network charges, instead of being recovered in one year, these rewards were spread over the 8 years of the RIIO price controls inline with the profile of Final Proposals allowed totex.

2.3. This profile was not intended to change during the course of the price control.

2.4. For both the transmission operator and system operator in the GT PCFM and for the system operator in ET, the profile is currently dynamically linked to the non-variant allowances. This means that if we decided to modify these allowances following this consultation, the ex-ante rewards/penalties in the earlier years of RIIO (which have already been recovered through network charges) will be removed and re-added into the later years, due to the front-loaded profile of the proposed adjustments.

2.5. To avoid unnecessarily re-profiling money within the control period, we are proposing to add additional rows to the model which record the original totex allowance profile. These are detailed in the next sections.

2.6. The profile is not dynamic for the electricity transmission operators, so this is not an issue for changes to NGET's allowances.

⁴ Further details are available in RIIO-T1: Final Proposals for National Grid Electricity Transmission and National Grid Gas –Cost Assessment and Uncertainty Supporting Document, Appendix 1.

RIIO-ET1 Price Control Financial Model

ET1: Modifications needed to facilitate the mid-period review

2.7. As the profile of ex-ante reward for the system operator is currently dynamic, we propose to add two extra inputs at the bottom of the *NGET SO* tab, row 115 onwards. These contain hard-coded versions of the original totex allowances (pre-MPR changes) on a per year basis as well as in total.

2.8. On the *SystemOperator* tab, the existing 'Original allowed totex (set at final proposals)' on row 169 and the 'Total allowed totex in price control (set at final proposals)' on row 170 have been relinked to the new static inputs. Note that data is only pulled into the *SystemOperator* tab when *NGET TO* is selected.

2.9. No changes are needed to the three electricity transmission operators ex-ante reward profiles, as they already point to static inputs.

ET1: Modifications to incorporate the mid-period review decision

2.10. We decided to reduce *NGET*'s allowance by £38.12m in 2009/10 prices, over the course of RIIO-ET1.

2.11. This type of expenditure is classified as the load related capex totex subcategory and is part of the non-variant pot.

2.12. We have therefore reduced the 'Non-variant allowed load related capex expenditure' on row 84 of the *NGET TO* tab by £38.12m in total.

2.13. As part of the MPR, we also decided to allow an additional £21.51m in totex allowances to *NGET SO*, to fund three additional responsibilities which were not original funded.

2.14. The new programme to encourage Demand Side Response is classified as controllable opex. The funding for the additional obligations under the Integrated Transmission Planning and Regulation (ITPR) project and for the new balancing services (DSBR and SBR) are split between the controllable opex and non-operational capex totex subcategories.

2.15. We have therefore increased the 'Non-variant allowed non-operational capex' on row 25 and the 'Non-variant allowed controllable opex' on row 26 of the *NGET SO* by £4.19m and £17.32m respectively.

2.16. The profile of each adjustment is shown in Appendix 1 - Calculation of revised allowances.

RIIO-GT1 Price Control Financial Model

GT1: Modifications needed to facilitate the mid-period review

2.17. We are also proposing to make changes to NGGT's totex allowance. Unlike the electricity transmission operators, the gas transmission operator's profile of ex-ante penalty is calculated dynamically. We have therefore added extra rows on the *NGGT TO* tab, row 338 onwards to capture 'Original allowed totex' and 'Total allowed totex'. These changes have been mirrored on the *Input* tab which pulls data from *NGGT TO*.

2.18. We have also relinked the existing 'Original allowed totex (set at final proposals)' on row 107 and the 'Total allowed totex in price control (set at final proposals)' on row 108 of the *TIM* tab to use the static rather than the dynamic inputs.

2.19. Although we are not proposing to make any changes to allowances for the gas system operator as part of the MPR, to maintain as much consistency between the models as possible we have replicated the change in ex-penalty spreading for NGGT SO.

2.20. Similar to the ET1 PCFM, we have added hard-coded inputs to row 115 onwards of the *NGGT SO* tab and linked the existing 'Original allowed totex (set at final proposals)' on row 169 and the 'Total allowed totex in price control (set at final proposals)' on row 170 of the *SystemOperator* to these static inputs.

GT1: Modifications to incorporate the mid-period review decision

2.21. As part of the MPR, we have decided to reduce NGGT's totex allowance for the Avonmouth pipeline by the amount not spent (£0.2m).

2.22. Avonmouth was one of the projects which made up the load related capex totex subcategory.

2.23. We therefore propose to reduce the 'Non-variant allowed load related capex expenditure' input on row 84 of the *NGGT TO* tab by £168.78m across the price control.

2.24. The profile of each adjustment is shown in Appendix 1 - Calculation of revised allowances.

Provisional PCFMs

2.25. A copy of the RIIO-ET1 PCFM and the RIIO-GT1 PCFM with the provision modifications included has been published on our website alongside this consultation document.

3. Next steps

Responding to this consultation

3.1. We welcome comments on the proposed modifications by Friday 21st April to matthew.brown@ofgem.gov.uk and mpr@ofgem.gov.uk or in writing to:

Matthew Brown
RIIO Finance
9 Millbank
London
SW1P 3GE

3.2. All responses to this 28 day statutory licence modification consultation must be provided by 21st April 2017.

3.3. Unless clearly marked confidential, all responses will be published on our website.

Outcome of this consultation

3.4. Once this consultation closes, we will consider all responses received. We intend to make our final decision on these modifications by early May. If we decide to make the proposed modifications, they will come into effect not less than 56 days following the publication of the decision.

3.5. If we decide to modify the PCFM's with the revised allowances, there will be no revenue impacts until the next Annual Iteration Process (AIP) is carried out. This will be completed by 30th November 2017, at which point the impact of changes mentioned in this consultation, alongside the regular updates to other variable values, will flow into the MOD_t value for 2018/19⁵.

3.6. It should be noted that the PCFM's included in this consultation are not the final models which will be used for the next AIP. We may need to make additional modifications to the PCFM for issues separate from the consultation.

3.7. The final PCFM for use in the 2017 AIP will be published on our website in early October.

⁵ There will also be subsequent revenue impacts for the MOD term in later years.

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Appendix 1 - Calculation of revised allowances

Revised Allowances for the RIIO-ET1 PCFM

NGET TO Non-variant Allowed Load Related Capex Expenditure

£m 2009/10 Prices

	31 Mar 2014	31 Mar 2015	31 Mar 2016	31 Mar 2017	31 Mar 2018	31 Mar 2019	31 Mar 2020	31 Mar 2021	Total
Final Proposals Allowance	241.92	206.22	183.48	187.40	142.93	124.46	44.07	28.38	1,158.86
Fault Level Protection Adjustment	(15.37)	(16.46)	(4.09)	(0.50)	(0.59)	(0.94)	(0.17)	-	(38.12)
Post-MPR Allowance	226.54	189.77	179.38	186.90	142.34	123.52	43.91	28.38	1,120.74

NGET SO Non-variant Allowed Non-operational Capex

£m 2009/10 Prices

	31 Mar 2014	31 Mar 2015	31 Mar 2016	31 Mar 2017	31 Mar 2018	31 Mar 2019	31 Mar 2020	31 Mar 2021	Total
Final Proposals Allowance	39.23	34.21	29.41	27.17	29.59	20.38	25.43	25.41	230.82
ITPR (Portion)	-	-	0.08	1.38	0.03	0.03	0.03	0.03	1.57
Balancing Services (Portion)	0.18	1.75	0.39	0.31	-	-	-	-	2.63
Post-MPR Allowance	39.41	35.96	29.88	28.85	29.62	20.41	25.46	25.43	235.01

NGET SO Non-variant Allowed Controllable Opex

£m 2009/10 Prices

	31 Mar 2014	31 Mar 2015	31 Mar 2016	31 Mar 2017	31 Mar 2018	31 Mar 2019	31 Mar 2020	31 Mar 2021	Total
Final Proposals Allowance	73.78	74.86	77.01	78.58	79.36	80.00	81.75	83.67	629.01
Demand Side Response	-	-	0.64	0.47	0.46	0.45	-	-	2.02
ITPR (Portion)	-	0.24	0.80	2.88	2.65	2.47	2.29	2.10	13.43
Balancing Services (Portion)	0.34	0.65	0.66	0.23	-	-	-	-	1.87
Post-MPR Allowance	74.12	75.75	79.10	82.16	82.47	82.91	84.05	85.77	646.33

Revised Allowances for the RIIO-GT1 PCFM

NGGT TO Non-variant Allowed Load Related Capex Expenditure

£m 2009/10 Prices

	31 Mar 2014	31 Mar 2015	31 Mar 2016	31 Mar 2017	31 Mar 2018	31 Mar 2019	31 Mar 2020	31 Mar 2021	Total
Final Proposals Allowance	25.46	14.41	9.62	60.45	84.88	8.52	0.23	-	203.57
Total Avonmouth Allowance	(10.49)	(8.29)	(8.39)	(59.39)	(78.93)	(3.47)	-	-	(168.96)
Options Assessment	0.15	0.04							0.19
Post-MPR Allowance	15.12	6.16	1.23	1.06	5.95	5.06	0.23	-	34.80

Appendix 2 - Feedback on this consultation

We want to hear from anyone interested in this document. Send your response to the person or team named at the top of the front page.

We've asked for your feedback in each of the questions throughout it. Please respond to each one as fully as you can.

Unless you mark your response confidential, we'll publish it on our website, www.ofgem.gov.uk, and put it in our library. You can ask us to keep your response confidential, and we'll respect this, subject to obligations to disclose information, for example, under the Freedom of Information Act 2000 or the Environmental Information Regulations 2004. If you want us to keep your response confidential, you should clearly mark your response to that effect and include reasons.

If the information you give in your response contains personal data under the Data Protection Act 1998, the Gas and Electricity Markets Authority will be the data controller. Ofgem uses the information in responses in performing its statutory functions and in accordance with section 105 of the Utilities Act 2000. If you are including any confidential material in your response, please put it in the appendices.

General feedback

We believe that consultation is at the heart of good policy development. We are keen to hear your comments about how we've conducted this consultation. We'd also like to get your answers to these questions:

1. Do you have any comments about the overall process of this consultation?
2. Do you have any comments about its tone and content?
3. Was it easy to read and understand? Or could it have been better written?
4. Were its conclusions balanced?
5. Did it make reasoned recommendations for improvement?
6. Any further comments?

Please send your comments to stakeholders@ofgem.gov.uk