

21 April 2017

James Turnley
RIIO Teams
Ofgem

Consultation on MPR Parallel Work – NGN Response

Dear James,

Thank you for the opportunity to respond to your consultation on the MPR Parallel Work.

The attached document sets out NGN's responses to the specific questions raised in the consultation where appropriate.

If you require any further information or clarification on the issues raised then please do not hesitate in contacting me.

Kind Regards



Gareth Mills
Head of RIIO
Northern Gas Networks

MPR Parallel Work Consultation

Background & Scope

Question: Do you agree with the scope of the MPR parallel work?

As the understanding of the RIIO framework evolves, alongside a more rapidly evolving operating environment, it is clear that in a small number of cases there is merit in ensuring that elements of the regulatory contract support the key principles of the framework. Done properly, this process can help support the stability and transparency of the regulatory framework.

However, large and/or frequent retrospective adjustments to the framework that do not adequately balance the risk/reward trade-off between customer and investors and has the potential to undermine the core principles of the regulatory framework.

In this instance, we believe that the scope of the MPR parallel work is appropriate and the stated principles are sound.

2. Output accountability

Question: Do you think we are right to focus on the output purpose where there is ambiguity to decide when an output is delivered? If not, please explain why and provide evidence.

Avoiding ambiguity in the definition of outputs within the regulatory contract is a key principle that should underpin the regulatory process. The RIIO-2 process should focus more on ensuring that definitions of outputs are clear to all parties and where appropriate how any risks that surround that output will be dealt with during the period of the price control.

However, it is also important to recognise that such clarity may not be achievable under all circumstances and may need to be reviewed. Under these circumstances we believe it is appropriate to focus on the 'purpose' of the output as the key consideration. This builds upon the principle of Primary and Secondary outputs with the RIIO framework whilst ensuring that the overall 'outcome' for customers is maintained.

The proposed approach for both National Grid Gas Transmission's compressors output and SP Transmission's voltage control seem to be an appropriate and balanced response to the issues raised in each case.

The concept of identifying desired 'Outcomes' alongside 'Outputs' within the framework may be a useful clarification within the regulatory contract and a considered as a development in RIIO-2.

Question: What do you think about our alternative options including focusing on the detailed output specification or output declassification? Will they achieve our purpose? Can you think of any other alternatives?

As outlined above we believe the most appropriate approach is to focus primarily on the purpose or intended outcome.

Focussing on the detailed output specification introduces two key risks.

- If companies are held to account for what was specified rather than the output's purpose you correctly identify that this removes the incentive for innovation or seeking alternative solutions.
- If further levels of details are sought to more tightly specify the output requirement, this too may impact the incentives on companies but also significantly increase the regulatory burden both in determining the appropriate solution and in monitoring its delivery.

3. Price control adjustments

When should we address gaps in the price control?

The core principles of the approach you have taken to consider and address 'gaps' in the price control are a reasonable basis on which to consider these issues. We would agree that not adhering to these principles would impact upon the credibility of the overall framework.

We would support the stated principle of ensuring that any retrospective adjustments must be in customer's interests. However, this principle can only be seen to support the overall framework where it can be judged to have been applied symmetrically. Customer interests can also be served by bringing forward or escalating allowances where appropriate to deliver outputs and outcomes. Without acceptance of this principle the low-risk nature of the regulatory framework loses credibility.

Western HVDC

Question: Do you agree with our proposed approach to delay allowances due to the delivery of the Western HVDC? If not, please explain why and provide evidence.

No Response

Question: Do you have any views on how we should delay allowances? Please explain and provide evidence.

No Response

Question: Do you have any view on how we should treat payments and in-kind benefits from suppliers paid to compensate for the delay? Please explain and provide evidence.

No Response.

London medium pressure

Question: Do you agree that we should accept National Grid Gas Distribution's (NGGD) proposal to return £53.9 million? If not, please explain why and provide evidence.

We would support Ofgem's proposal to accept the return of the allowances allocated to NGGD for specific work programme in London during RIIO-GD1.

It is clear that at this stage it is in the customer's interests to not fund this activity until surety can be provided on the ability to deliver the planned programme and the associated benefits for customers. It is also clear at this stage that alternative approaches to the delivery of the outputs cannot be identified and as such does not impact upon the incentives faced by NGGD.

The justification for the remainder of this programme can be considered again fully at RIIO-GD2 if appropriate.

Clarity from Ofgem on how cases where there is clear additional benefit for additional work to be carried out and benefit delivered for customers within a price control period would add to the transparency of any MPR or Parallel Work going forward.

Connections volume driver

Question: Do you agree with our proposed approach not to amend SPT's connections volume driver? If not, please explain why and provide evidence.

The principle of including a cost driver within the regulatory framework is to ensure that where there is uncertainty over the delivery of an output a mechanism is in place to ensure that the network is only funded for output that is delivered and customers do not pay for output that is not delivered. This is an effective and appropriate way in which uncertainty and hence risk is shared between networks and customers.

The level of detail within the consultation makes it difficult to understand fully the complexities of this arrangement. However, the issue faced by SPT would seem to be one of the volume driver being incorrectly specified and being ineffective in managing the uncertainty and risk.

As such Ofgem's proposal to not correct for these issues with the operation of the uncertainty mechanism would seem to be a reversal of the position that these risks associated with connections volumes cannot be allocated fully to SPT. We would not support this proposal as part of this work stream.

NTS exit capacity incentive

Question: Do you agree that we should not make changes to the NTS exit capacity incentive? If not, please explain why and provide evidence.

We would agree with your proposal not to make changes to the NTS exit capacity incentive.

The principle that exposing users to rewards/penalties for using less/more than efficient baseline figures is sound. Furthermore, basing this incentive framework on prices for capacity derived from an approved methodology for calculating long run incremental costs of capacity ensure that GDNs have an incentive only to use levels of capacity that are required to meet its needs. It also incentivises the network to investigate and where appropriate implement cost effective solutions to reduce capacity requirements at our NTS offtakes.

NGN has reduced its required capacity at a number of key offtakes over RIIO-GD1 releasing capacity back to the NTS, reducing requirements for further investment to support transmission capacity.

The challenge to this incentive would seem to focus more on the transparency of how these reductions in capacity are reflected in prices and the benefit delivered to customers. We support a review of the transmission pricing arrangements to ensure they are providing the correct economic signals for access to and use of capacity.

Gas distribution outputs

Safety repair risk

Question: Do you agree with our proposed approach to continue to monitor this output for the remainder of RIIO-GD1 and require companies to justify where they fail to meet this output? If not, please explain why and provide evidence.

At the outset of the RIIO-GD1 price control decisions were made regarding the regulatory approach to each output. Some have specific financial penalties /rewards depending on performance (e.g. customer service), some have specific licence obligations (e.g. emergency standards) and some have reputational incentives (e.g. business carbon footprint). Changing the nature of these approaches part way through a price control is not good regulatory practice as it could significantly shift the balance of risk and reward. However, where there is a consistent pattern of failure with no sanction this could undermine customer and stakeholder confidence in the RIIO framework. Therefore there has to be some balance between these two drivers.

In our view there should be a mechanism for the consequence of repeated failure against an output to be escalated where there is no satisfactory explanation for the failures or there is no sign of improvement. The first stage escalation in these circumstances should be to require the company to submit a performance improvement plan and incorporate the targets in that plan into a licence requirement for the specific company. This provides the opportunity for enforcement action should

the pattern of failure continue. We think this would be an appropriately balanced and measured approach.

The repair risk output measure is encouraging the right behaviour with NGN and the majority of GDNs delivering the requirements set out in the regulatory contract. In this particular instance if Ofgem is satisfied with the plans for improvement by the company failing the output then continued monitoring of the performance may be the appropriate approach in this instance.

The wider consideration of including regulatory approach to the failure of an output requires further review as part of preparations for RIIO-2. Our suggestion of an escalation process for outputs which ultimately leads to enforcement action under the licence should be part of this. Ofgem's response to the issues raised in the MPR Parallel work stream has indicated the challenges of specifying unambiguously where and when outputs are considered fully delivered and the benefit of taking a more holistic view of overall outcomes for customers.

Reliability loss of supply

Question: Do you agree that we should change the targets for the loss of supply output for the remainder of RIIO-GD1, continue to monitor performance and require companies to justify where they fail to meet this output? If not, please explain why and provide evidence.

We support Ofgem's proposals to change the targets for loss of supply for the remainder of RIIO-GD1.

It is appropriate that the regulatory framework retains the flexibility to act upon new information and knowledge that allows changes to be made that better serves customers. Output targets that are not achievable due to errors in base data and understanding of targets and forecasts cannot work in the long term interests of customers as they cannot be seen to drive correct behaviours.

Maintaining operational performance

Question: Do you agree with our proposed approach to make no changes to this output for the remainder of RIIO-GD1, to continue monitoring this output and to require companies to justify where they fail to meet this output? If not, please explain why and provide evidence.

We support Ofgem's proposals to not introduce any change for maintaining operational targets outputs for the remainder of RIIO-GD1. We would agree that the outputs are working well and driving the right behaviours. In this instance there is no repeated pattern of failure that would merit escalation.

SPT's Trigger mechanism

***Question: Do you agree with our proposed approach to this trigger mechanism?
If not, please explain why and provide evidence.***

No response

Electricity transmission other outputs

Question: Do you agree with our approach to these output

No response