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Our ref

Your ref

Date

-

8th March 2017

Dear James,

Consultation on mid-period review parallel work

I am writing on behalf of Western Power Distribution (South Wales) plc, Western Power Distribution (South West) plc, Western Power Distribution (East Midlands) plc and Western Power Distribution (West Midlands) plc in relation to Ofgem's consultation on mid-period review parallel work.

As a Distribution Network Operator we are not directly impacted by the proposals within the consultation, but we have an interest in the process because some of the approaches being considered could establish precedents that could be applied across sectors under the RIIO framework.

At a high level, our main observation is that the parallel work is seeking to clarify parts of the RIIO-T1 and RIIO-GD1 price controls and establish adjustment mechanisms where 'gaps' in the price control have been identified. As part of the RIIO strategy decisions it was prescribed that uncertainty would be addressed through pre-defined uncertainty mechanisms or the development of new processes would be 'signalled' to licensees at the start of a price control as activities to be resolved during the price control. Any deficiencies identified during the price control would be addressed as part of the strategy for the following price control. Introducing new changes during a price control potentially increase the risks for licensees, and have wider price control implications such as the cost of capital.

With regard to specific proposals, our main concern relates to making adjustments to allowances to reflect delays in projects. We recognise that the change is being proposed for the very high value (£1bn) Western HVDC project, which had specific deadlines. The proposals will set a precedent which could lead to similar adjustments for other projects. Delays to projects can occur for various reasons and licensees may reschedule (re-phase) work to take advantage of resource availability. This may include bringing projects forward. If adopted, we would urge Ofgem to limit the application of delay adjustments to very high value projects that are pre-identified as candidates for such action at the start of a price control. The adjustments should also become symmetrical, such that if a project has to be started earlier, similar timing adjustments are also applied.

We provide specific responses to the questions posed in the consultation within the attached appendix.

Should you wish to discuss any aspects of this response please contact amichalowski@westernpower.co.uk or pbranston@westernpower.co.uk.

Yours sincerely

A handwritten signature in black ink, appearing to be 'AS', written in a cursive style.

ALISON SLEIGHTHOLM
Regulatory & Government Affairs Manager

Appendix – Responses to specific questions in the Consultation

Chapter 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.

→ **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?

We propose that the focus should be on the output purpose, rather than the solution used to achieve the output. This provides the licensees the opportunity to innovate and adopt lower cost solutions which can lead to savings that can be shared with customers through established total expenditure sharing mechanisms.

National Grid Gas Transmission's compressors output

→ **Question:** Do you agree with our proposed approach to hold NGGT to account if it complies with the IED requirements? If not, please explain why and provide evidence.

We agree. This assesses the delivery of the output based upon the purpose for doing the work.

SP Transmission's voltage control

→ **Question:** Do you agree with our approach to consider the output delivered if SPT manages voltage across its network efficiently? If not, please explain why and provide evidence.

We agree. The purpose of the activity is voltage control and therefore assessment should be against achieving this objective.

Chapter 3 Price Control Adjustments

When should we address gaps in the price control?

As stated in paragraph 3.2, the RIIO model was designed to provide certainty and transparency and consequently Ofgem would seek to avoid any retrospective adjustments once a price control had started.

Licensees accept price controls as an overall package, trading off possible positive benefits with more challenging aspects. Ofgem introduced uncertainty mechanisms where costs and requirements were not fully identifiable at the time of setting price controls. These protect the interest of both customers and licensees, but form part of the price control package. The introduction of retrospective and un-signalled adjustments that reduce the possible benefits to licensees impact this overall price control package and therefore increase the risk to licensees.

In the interest of maintaining certainty and transparency, only price control gaps that are identified at the start of a price control and which have been signalled as being required to be addressed should lead to changes during the price control. Any other gaps that are identified should form the basis of regulatory strategy for the following price control.

The introduction of ex-post adjustments reduces certainty and increases risk to licensees.

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

The Western HVDC project is a very high value project which is made more complex by the interaction with constraint payments to generators. It is being delayed due to issues with equipment manufacture which is not directly under the control of the licensees.

The proposal seeks to revise allowance levels to remove the potential timing benefits to the licensees of deferred expenditure.

Paragraph 3.15 identifies that Ofgem did not specify any penalties for late delivery, but there would be a review of deviations against completion timescales. This provided NGET and SPT with advance warning that delays would be reviewed as potential licence condition contraventions, but there is no indication that allowances would be adjusted.

Seeking to apply adjustments to allowances is therefore an 'un-signalled' change to the price control package. 'Un-signalled' changes to the price control package increases risk for licensees.

The introduction of re-profiling of allowances for this project will set a precedent for application to other projects. Licensees regularly re-phase projects to take advantage of resource availability, outage opportunities, changed circumstances, etc. Any such re-profiling of allowances should be reserved for projects where this type of adjustment has been signalled at the start of a price control and should only apply to a small number of

very high value projects. The application of ex-post allowance profile adjustments more generically across the price control should be avoided because the impact of variances to allowances are already shared with customers through the total expenditure sharing mechanisms applied through defined annual iteration processes.

If the principle of re-profiling allowances is extended to other projects, it should be applied symmetrically such that early delivery of projects leads to additional allowances for licensees.

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.

The offer appears to recognise that a specific pre-defined output will not be delivered. Returning the funding in the current price control, provides a clearer path for NGGD to ask for funding for the completion of the programme in future price controls.

This process however, raises questions of National Grid's well justified business plan. It is not clear how adjusting allowances, expenditure and associated outputs in this way would interact with existing incentive mechanisms, such as the IQI.

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. 3.55.

No comments

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

No comments

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.

We agree. These are new measures that were introduced for RIIO-GD1 and Ofgem should take the opportunity to learn from the issues with the measures to establish a more robust measure for RIIO-GD2.

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 disagree.

These are new measures that were introduced for RIIO-GD1 and Ofgem should take the opportunity to learn from the issues with the measures to establish a more robust measure for RIIO-GD2.

Failure against targets should not be seen as a reason to re-set the targets. Improvements to performance can still be made over time and therefore there should be an incentive for GDN to continue to improve performance.

If there are deficiencies in setting the targets, these should be addressed and better targets published for RIIO-GD2.

Targets should not be changed part way through a price control unless such a change was signalled at the start. Take for example the time to quote and time to connect measures used for connections to electricity distribution networks where Ofgem explicitly stated that the target would be reset at the mid-point of the RIIO-ED1 price control.

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 agree. These are new measures that were introduced for RIIO-GD1 and Ofgem should take the opportunity to learn from the issues with the measures to establish a more robust measure for RIIO-GD2.

SPT's Trigger mechanism

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

This appears to be adequately covered by the NOMs arrangements.

Electricity transmission other outputs

→ **Question:** Do you agree with our approach to these outputs?

The proposals for allowing existing mechanisms such as the total expenditure sharing mechanism to deal with late or non-delivery of some outputs is appropriate.

As stated earlier these mechanisms were in place at the start of the price control and form part of the overall price control package.