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2 February 2018

Mr. Steven McMahon
Associate Partner, RIIO Electricity Networks
Ofgem
Commonwealth House, 3rd Floor
Albion Street
Glasgow G1 1LH

Dear Mr. McMahon,

Thank you for the opportunity to respond to the Consultation on a potential RIIO-ED1 Mid-Period Review (MPR).

Our response to the Consultation primarily focuses on two areas of concern: the impact we believe an MPR would have on debt and equity investor sentiment; and the potential for increased costs for consumers should the scope of the MPR be expanded beyond that which was originally defined by Ofgem and, consequently, relied upon by Western Power Distribution (WPD) and the other network operators.

WPD is providing a separate response that includes a detailed review of each of the three options addressed in the consultation document. WPD's conclusion is consistent with our view that only Option 1, "Maintaining the scope of the MPR as defined in the RIIO-ED1 Strategy," warrants consideration for a potential MPR. Below are a few key highlights of WPD's response:

- The potential for significant incremental costs to U.K. consumers exists because changing the scope of the MPR undermines regulatory predictability and increases regulatory risk, factors that will lead to higher future financing costs.
- The perception of asymmetric regulatory risk will impact future price controls if an MPR is extended to include WPD's cost for rail electrification (Option 2), specifically given that WPD agreed to take on the risk of overspend on these projects in its settlement with Ofgem.
- An extension of the MPR to include specific rail electrification projects outside of the previously defined scope would be imbalanced as it ignores other material cost increases to WPD, such as the cost to transition to a Distribution System Operator (DSO).

- Furthermore, WPD has been significantly disadvantaged on a cost of debt recovery basis due to an early settlement as a fast-tracked company with a "well-justified business plan" that did not include trombone debt indexation.

***PPL's Response to a Potential MPR***

PPL Corporation (PPL) is the ultimate parent of the four WPD electricity distribution network operators. PPL is one of the largest companies in the U.S. utility sector and comprises seven high-performing, award-winning utilities that serve more than 10 million customers in the U.S. and United Kingdom.

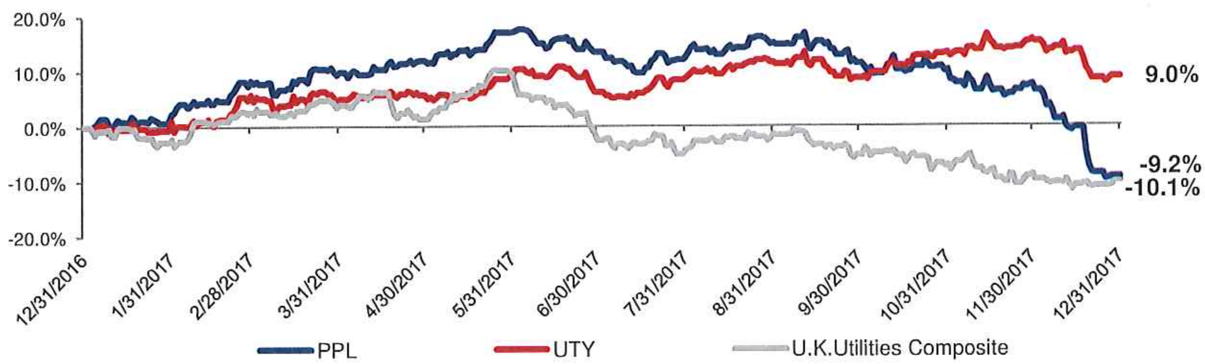
A key aspect of PPL's investment proposition is that 100 percent of our earnings originate from low-risk, stable regulated entities. Institutions invest in PPL because they value predictable earnings and cash flows driven by long-term infrastructure investments that translate into stable yields and returns. Regulatory integrity is critical to this investment proposition. Any uncertainty introduced into the regulatory framework elevates the risk premium required for investment, which could result in higher costs to customers in future price controls.

Specifically, in the case of the U.K., the established, high-quality regulatory jurisdiction was a key factor in our decision to invest in and significantly grow our ownership of U.K. regulated operations. Historically, our investors have agreed with our view that the U.K. regulatory regime is a premier jurisdiction. We believe that is primarily due to the U.K.'s incentive-based structure, the U.K.'s regulatory cycle durations, which provide longer-term predictability, and the inclusion in the regulatory framework of pre-defined (but limited) mechanisms that adjust for uncertainty and volatility. Further, investors have appreciated that WPD's networks have been top performers and consistently rank at the highest level in reliability, customer service and satisfaction. WPD continues to achieve those high standards in RIIO-ED1, despite challenging targets. At the same time, WPD continues to develop cost-effective and innovative business plans, informed by extensive stakeholder engagement, to meet new challenges and create the networks of the future.

Unfortunately, the recent scrutiny of the U.K. regulatory regime and the uncertainty created by that scrutiny has significantly weakened investor confidence in the reliability of Ofgem and in the stability and premium nature of U.K. regulation. As noted above, investors have regarded the U.K. as a premier regulatory jurisdiction, which has facilitated investment in Ofgem-regulated entities. However, given that two of the options being considered under the ongoing Consultation are, as recognized by Ofgem, outside of the MPR scope established under RIIO-ED1, this has caused investors to seriously question the viability of long-term investment in Ofgem-regulated businesses. We caution Ofgem that a decision to pursue an MPR outside of the previously defined scope would amplify investor questions and concerns. We believe that these concerns may seriously deter future investment in Ofgem-regulated businesses, and/or increase the risk premium for investment above that which is already present due to political uncertainty as the U.K. addresses its exit from the European Union. If one or more of these outcomes is realized, we believe it will lead to increased costs for U.K. customers in the future.

PPL was one of the top performing U.S. utility stocks through May of 2017 as our businesses successfully executed their business plans. As the chart in Figure 1 below shows, and notwithstanding the continued successful operation of our businesses, our trajectory has changed as uncertainty regarding the RIIO-ED1 framework has increased and confidence in the integrity of the U.K. regulatory construct has decreased. Given how well our businesses were performing, we asked investors directly for their perspective. In response, they unanimously cited U.K. regulatory and political uncertainty, driven primarily by the possible MPR, RIIO-ED2 and the potential re-nationalization of the electricity sector, as the sources of their unease. As can be seen below, the rhetoric and lack of clarity surrounding the RIIO regulatory construct weighed heavily on U.K. utilities. This should be viewed by Ofgem as a clear and direct signal from the market that confidence is waning in U.K. regulation, including Ofgem regulation, which will ultimately increase the equity risk premium required to support continued investment in the U.K.

**Figure 1.**




Note: The Philadelphia Utility Sector Index (UTY) is a market capitalization-weighted index composed of geographically diverse public utility stocks. The U.K. Utilities Composite reflects the indexed average price performance of National Grid, Pennon Group, SSE, Severn Trent and United Utilities.

We cannot overstate the impact this uncertainty has had on investor confidence in U.K. regulation in general, and Ofgem regulation specifically. PPL has always appreciated the independence Ofgem has exhibited in creating a regulatory framework that balances customer needs with the need for investors to earn fair returns. We believe the RIIO framework is effective in balancing different stakeholder needs, demonstrating a strong focus on outputs and incentivizing distribution network operators (DNOs) to provide value for customers through the delivery of those outputs. While we recognize that Ofgem may desire more differentiation in RIIO-ED2 in terms of the financial metrics of the best and worst performing companies, PPL and WPD believe the incentive regulation model is sound and is driving the right behaviors by the DNOs. More importantly, we strongly believe that incentive regulation benefits customers, driving increased reliability, improved cost performance and higher customer satisfaction and engagement. An MPR that is beyond the scope originally defined by Ofgem would undermine investor and DNO confidence in the reliability of the RIIO-ED1 incentive framework, and it is likely that DNOs would have less incentive to achieve efficiencies and strong customer service in the future. Moreover, this would likely cast doubt on the integrity of the RIIO-2 construct as well. Given the substantial future investment in the U.K. electricity networks that will be required to meet electrification and carbon reduction goals of the U.K., we believe Ofgem should maintain as much stability and certainty in regulation as possible. Doing so will encourage the investment needed to advance a cleaner energy future in the U.K.

In addition to the prospect of eroding investor confidence in the RIIO-ED1 framework, we also believe that expanding the MPR scope as suggested in Options 2 and 3 contravenes the understanding that WPD and other DNOs reached with Ofgem when RIIO-ED1 was implemented. WPD has incurred significant increases in costs that were not contemplated at the outset of RIIO-ED1. Those costs are attributable to, among other factors, expanded solar connections, transitioning to a DSO, and, as highlighted in WPD's response to the Consultation, under-recovery of interest costs. Neither we, nor WPD, had any intention of requesting an adjustment for these factors in the MPR, as we believe we should honor the terms WPD agreed with Ofgem. Any issues we experience in RIIO-ED1 should be taken up in RIIO-ED2. We firmly believe that Ofgem should do the same, leaving Option 1 as the only appropriate alternative in the Consultation.

In conclusion, we strongly recommend that Ofgem maintain the scope of the MPR as defined in the RIIO-ED1 Strategy Decision (Option 1). An expansion of the MPR scope is unwarranted, will unreasonably introduce additional risk and potential future costs, and will conflict with Ofgem's principal objective "to protect the interests of existing and future electricity and gas consumers." WPD has as strong track record of delivering on the commitments it made to Ofgem and its stakeholders. I expect nothing less from WPD, and I expect Ofgem to uphold its commitments as well.

If you have any questions or would like to discuss our response, please do not hesitate to contact me.

Sincerely,

William H. Spence
Chairman, President and CEO
PPL Corporation