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Dear Steve,

Consultation on a potential RIIO-ED1 Mid-Period Review

This response is provided on behalf of National Grid Electricity Transmission plc (NGET) and National Grid Gas plc (NGG) as National Grid. NGET owns the electricity transmission system in England and Wales and is the National Electricity Transmission System Operator (NETSO). NGG is the owner and operator of the high pressure gas for all of Great Britain. This response is not confidential.

Whilst National Grid may not be directly subject to the RIIO-ED1 Mid-Period Review (MPR), there is the potential for this consultation and any subsequent decision to have consequential effects across the sectors regulated by Ofgem. Our response focuses on one principal issue within the consultation, namely the potential to broaden the scope and therefore purpose of the MPR from that which has previously been defined, set out and agreed in the ED1 price control settlements.

Broadening the scope of the MPR compared to that agreed as part of the settlement would constitute a clear re-opening of the ED1 price controls. We have set out evidence for this in appendix 1. Re-opening price controls is not in consumers' interests because:

1. It creates regulatory uncertainty which undermines investor confidence in the regulatory regime, which in the long run increases cost of capital and therefore costs to consumers.
2. It undermines the incentives, which are fundamental to the RIIO model, for companies to drive improvements, innovations and efficiencies - all of which are in consumers' interests.

Ofgem and other stakeholders should bear in mind that confidence in regulatory stability and predictability is hard won but easily lost, but is essential if the financing costs required by debt and equity investors are not to increase.

If you have any questions regarding this response please contact Jenny Owen (01926 656985) in the first instance.

Regards

[by email]

Chris Bennett

Appendix 1

As Ofgem recognise in the consultation, the scope of the ED-MPR was defined in the RIIO-ED1 Strategy Decision:

“The scope of the mid-period review of output requirements will be restricted to cover:

- Material changes to existing outputs that can be justified by clear changes in government policy (e.g. if government policy on climate change changes, a higher or lower level of delivery or performance may be needed)*
- Introducing new outputs that may be needed to meet the needs of consumers and other network users.”*

Furthermore, the consultation notes that the RIIO-ED1 Strategy Decision clarified that the MPR process is not an opportunity to conduct a mini price review, and in addition the March 2013 Strategy Decision gave a number of other clarifications as to the scope of the mid-period review in RIIO-ED1 including that it was: *“a tightly-defined mid-period review of output requirements”*; *“will not be used to reduce charges to consumers where a company has delivered at lower costs than expected at the price control review, or to increase charges to consumers when costs have been higher than expected ...”*; *“is not intended to be an opportunity for either Ofgem or the DNOs to conduct a mini price review”*; and *“the mid-period review should not be seen as an opportunity to re-open decisions taken at the price control.”*

As recently as January 2017, the purpose and limited scope of the MPR was explained in Ofgem’s ‘Guide to the RIIO-ED1 electricity distribution price control’:

*“15.13. There is a chance that outputs may need to change significantly during the eight-year price control period. The RIIO framework therefore includes a mid-period review of output requirements. We recognise this risks undermining the purpose of setting a longer price control period. Consequently, we have restricted the scope for the mid-period review to changes to outputs that can be justified by clear changes in government policy and the introduction of new outputs that are needed to meet the needs of consumers and other network users. **It is not an opportunity for either us or the DNOs to conduct a mini price review or re-open decisions taken in the RIIO-ED1 review.**”*

It is, therefore, apparent that the ED1 price control set a clear expectation of which matters would (and would not) be considered in the mid-period review, and an extension to the scope now would be inconsistent with the commitments that were given prior to the start of RIIO-ED1 as to the scope of the MPR

Ofgem gave explicit assurances and commitment that such changes would not be made. As explained in the original RIIO Decision (October 2010):

*5.10 There was a mixed response to our proposed extension of the price control period to eight years. While some recognised the benefits that it could deliver in terms of encouraging longer-term thinking, a number of the network companies were of the view that extension of the price control could lead to greater risk and suggested that it would only have a marginal impact on longer-term thinking. **A number of concerns were expressed with respect to the mid-period review of outputs and, in particular, the ability to maintain the narrow scope of the review.** Respondents were concerned that the mid-period review may turn into a full blown review and therefore effectively reduce the price control from five to four years.*

*5.11 **We think that these concerns can be mitigated through** careful design of automatic adjustment mechanisms (e.g. inflation indexation), uncertainty mechanisms **and a clear articulation of how the mid-period review of outputs will work and what will and will not be reviewed.** This will be set out as early as possible at each price control review. Investors and consumers of network services will therefore be better able to understand and make assumptions about how revenue might evolve during the period.*

Also in the RIIO Implementation Handbook (October 2010):

11.13. As discussed in Chapters 5 and 11 we will include provisions for a review of the primary outputs that network companies are required to deliver mid-way through the eight-year period. ...

11.14. Details of how the review will work as well as details of what will be included within scope will be signalled early in the price control review process. These aspects of the mid-period review will subsequently be specified in final proposals, and in licences. We will provide commitment that any mid-period review will not extend to other aspects of the control. Other elements of the framework will be used to manage issues that are outside the scope of the mid-period review. These include but are not limited to uncertainty mechanisms, updates to cost of debt based on a ten-year trailing average, adjustment for the efficiency incentive rate within period, and rewards/penalties for output delivery. The tightly defined scope of the review will be necessary to manage any risk of undermining the incentive benefits of the longer price control period.