SP ENERGY NETWORKS

Network Planning & Regulation

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By email only to:
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Your ref

Our Ref

Date
2nd February 2018

Contact / Extension
Jim McOmish
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Dear Steve,

Consultation on a potential RIIO-ED1 Mid-Period Review (MPR) (published 1 December 2017)

SP Energy Networks (SPEN) welcomes the opportunity to respond to this consultation as it deals with a number of material considerations for both customers reliant upon our industry and the investors that support it.

The approach that SPEN has taken in considering our response to the consultation is to consider specifically the original stated purpose and scope of the MPR, which limited the MPR to considering material changes in costs arising from changes in government policy or new outputs necessary to meet the needs of consumers and other network users. There are a number of items identified in the consultation that SPEN believe clearly satisfy this criteria and merit consideration of additional allowances or new reopener mechanisms.

SPEN's position in relation to the matter of financial and incentive performance and design is that these matters clearly do not satisfy the original MPR criteria. To significantly extend the scope of the MPR to capture these would have a materially detrimental effect on consumers in the longer term due to the damaging effect this would have on trust and confidence in the regulatory system and future financing costs.

A decision to widen the scope of the MPR as contemplated by Option 3 in Chapter 3 and the draft impact assessment (appendix 1) would be a material departure from Ofgem's clear, unqualified statements that the MPR would not be widened in the manner contemplated. The very act of widening the MPR in this way would be materially damaging to investor confidence and increase the cost of capital in the longer run. It would also potentially have a negative effect on the cost of capital for the Transmission Owners and the Gas Network Owners.

Widening the scope of the MPR would weaken trust and confidence in Ofgem's regulatory regime and the commitments Ofgem make in future. This would not be in the interests of consumers. This is the case even if a "mini price review" did not ultimately result in a change to the position.

The attachment to this letter provides our detailed response on each matter in turn. In summary:

- The criteria have been satisfied for an MPR on issues 1 to 6 affecting all DNOs and an MPR should be established to consider the material costs arising or new reopener mechanisms where there is remaining uncertainty;
- We accept Ofgem's position on issue 7, changes to Smart Metering intervention costs. However the MPR criteria have been satisfied for an MPR on Smart Metering efficiencies applied to slow track DNOs which are impacted by the Smart Metering delays;
- The criteria have been satisfied for an MPR on Issue 8 (Rail electrification) affecting WPD;
- The scope of the MPR should not be extended significantly to consider Financial and Incentive Performance and Design; and
- The proposals to implement the prior ED1 decisions on Load Index (LI) and Time To Connect (TTC) targets should progress.

In considering those areas SPEN believe should be subject to the MPR review, we have considered the potential benefits to consumers in either conducting a MPR or allowing for reopeners. We have categorised Issues 1 to 8 set out in Chapter 2 of the Consultation as follows:

<u>Category 1</u>
Issues where there is a clear change in government policy, there is a reasonable expectation that the costs can be established with an acceptable degree of certainty within the period of an MPR, and they are likely to be material. In these cases there should be an MPR which will confirm the materiality as well as the treatment of these costs.

<u>Category 2</u>
Issues where it is expected there could be a change in government policy, or there is a clear change in government policy but the costs cannot be established with an acceptable degree of certainty. In these cases then there should be an MPR which establishes new reopener mechanisms for the second half of the ED1 period. Such mechanisms would as standard have a materiality threshold which is designed to protect consumers and ensure an appropriate risk allocation between DNOs and consumers.

<u>Category 3</u>
Issues where there may be major changes in government policy but there is uncertainty regarding the nature and timing of these changes. These should be considered in the MPR for reopener mechanisms subject to greater certainty regarding timing and understanding of government policy.

<u>Category 4</u>
Issues which we consider do not satisfy the MPR criteria

Category 1 - MPR

The following fall into this category in order of materiality:

- **Issue 5: Black Start;** there are new material costs arising from meeting the anticipated government request to plan for a greater than 7 day event rather than 72 hours (the guidance provided for ED1). This policy change is important for national security reasons.
- **Issue 8: WPDs Rail Electrification Costs;** SPEN support an MPR to consider the reduction in costs resulting from a clear change in government policy.
- **Issue 3: National Flood Resilience Review;** there are new material costs to satisfy the important requirements communicated by government which are designed to protect consumers.
- **New Issue: Smart meters**; the consultation does not consider the impact on wider DNO costs from the smart meter programme delays. In particular delays to the achievement of projected efficiencies driven by the new information from smart meters.

Category 2 - MPR to establish new reopener mechanisms

The following fall into this category:

- **Issue 2: Implementation of the European Clean Energy Package;** This proposes significant new obligations for DNOs and in particular DNO compensation to renewable generators whose output is constrained for any reason. We believe there is a clear need for a reopener mechanism to cover this cost.

Category 3: Consider MPR to introduce reopener mechanism

The following fall into this category:

- **Issue 1: Electric Vehicles;** A number of government announcements during 2017 are likely to stimulate a more significant adoption of electric vehicles across GB than was previously forecast in order to satisfy the UKs environmental targets. The UK and Scottish governments approach to achieve this may have a material impact on DNOs costs in ED1. We believe that there is a clear need for a reopener mechanism to cover these possible outcomes and discrete incremental activities.
- **Issue 6: Whole-system outcomes and the transition to Distribution System Operator (DSO);** Government's expectations of DNO's roles and responsibilities may change significantly during the remainder of ED1 to enable the transition to DSO, and may result in significant increased costs during ED1 for DNOs. A reopener mechanism may be justified in this area to address discrete new activities.

Category 4: No MPR, criteria unlikely to be satisfied:

The following fall into this category

- **Issue 4: Resilience of Networks and Information Systems;** clearly meets the criteria but is likely to fall short of the necessary materiality thresholds. This detail will not be known until later in ED1 so a reopener mechanism may be justified in this area.
- **Issue 7: Smart meters**; we understand the position that Ofgem has set out in relation to intervention costs.

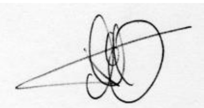
Several of the issues under consideration involve very important policy decisions relating to security of supply, the environment and demand on the electricity network in the UK, in particular issues 1, 3 and 5 (Electric Vehicles, National Flood Resilience Review and Black Start). It is essential that DNOs are able to react to any significant Government policy changes in an agile way. The MPR provides an important opportunity for Ofgem to review these issues and either provide for additional allowances or new reopener mechanisms to ensure that DNOs are able to deliver material changes to outputs or new outputs that result from any significant policy changes.

Load index Outputs and Time to Connect Targets

SPEN support the approach set out at the end of Chapter 3 to continue to develop Load Index (LI) outputs for RIIO-ED2 and reset the Time To Connect (TTC) targets as it is consistent with the previous plans communicated by Ofgem. Development of the LI for ED2 will allow Ofgem and stakeholders to better understand the impact of the uptake of low carbon technologies and active network management solutions that result in higher network utilisation but enable a greater pace of low carbon transition. SPEN believe that the TTC target setting process should also be consistent with that originally used for ED1. To take account of different commercial and reporting practices between DNOs it should be a DNOs own historic performance that set its targets.

Should you or your team have any follow up questions to clarify the points that we make in this response please do not hesitate to contact me.

Yours sincerely,



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Attachment: Appendix 1 – SPEN detailed responses to questions asked

Appendix 1:

SP Energy Networks (SPEN) detailed response to the Consultation on a potential RIIO-ED1 Mid-Period Review (MPR)

QUESTIONS RAISED IN CHAPTER 2

Chapter 2, Question 1: Should an MPR be established to consider one or a number of a range of external factors affecting all DNOs in RIIO-ED1 (issues 1 – 7) and WPD only (issue 8)

We believe that the MPR criteria have been clearly met across issues 1 to 6 for all DNOs and issue 8 affecting WPD only. There are some questions on materiality that remain to be addressed which we believe should be considered during an MPR. There is an additional category of costs that should be considered for issue 7 affecting all DNOs except WPD. In considering those areas SPEN believe should be subject to the MPR review, we have considered the potential benefits to consumers in either conducting a MPR or allowing for reopeners. We have categorised the Issues set out in Chapter 2 of the Consultation as follows:

Category 1: Issues where there is a clear change in government policy, there is a reasonable expectation that the costs can be established with an acceptable degree of certainty within the period of an MPR, and they are likely to be material. In these cases there should be an MPR which will confirm the materiality as well as the treatment of these costs.

Category 2: Issues where it is expected there could be a change in government policy, or there is a clear change in government policy but the costs cannot be established with an acceptable degree of certainty. In these cases then there should be an MPR which establishes new reopener mechanisms for the second half of the ED1 period. Such mechanisms would as standard have a materiality threshold which is designed to protect consumers and ensure an appropriate risk allocation between DNOs and consumers.

Category 3: Issues where there may be major changes in government policy but there is uncertainty regarding the nature and timing of these changes. These should be considered in the MPR for reopener mechanisms subject to greater certainty regarding timing and understanding of government policy.

Category 4: Issues which we consider do not satisfy the MPR criteria

SPEN's assessment of each of the issues against the categories is set out below:

Category 1 – MPR (in order of materiality)

- **Issue 5: Black Start;**
- **Issue 8: WPDs Rail Electrification Costs;**
- **Issue 3: National Flood Resilience Review; and**
- **New Issue: Smart meters (other costs)**;

Category 2 - MPR to establish new reopener mechanisms

- **Issue 2: Implementation of the European Clean Energy Package.**

Category 3 – MPR to consider if there is sufficient certainty to establish a reopener

- **Issue 1: Electric Vehicles; and**
- **Issue 6: Whole-system outcomes and the transition to DSO.**

Category 4 – No MPR due to criteria or materiality

- **Issue 4: Resilience of Networks and Information Systems; and**
- **Issue 7: Smart Meter (intervention costs).**

The following section sets out the detailed reasoning behind SPEN's assessment of each of these issues in the order set out above.

Issue 5: Black Start (Category 1 MPR)

There are new material costs arising from meeting the anticipated government request to plan for a greater than 7 day black start event rather than 72 hours (the guidance provided for ED1 by Ofgem).

During the ED1 price control review DNOs built their Black Start resilience plans for their grid and primary substations based upon the BEIS instruction at that time that the updated National Risk Register assumed a black start event would take 72 hours to recover rather than 48 hours.

SPEN is fully engaged with National Grid, as well as BEIS and Scottish Government, on issues related to ensuring system security and operability in Great Britain. This is a high risk issue to the UK as the closure of self-starting and thermal generation has reduced diversity in restoration options over time and extended restoration timescales in relation to an event where all of the lights go off, referred to as Blackstart.

The recent Northern Security Study, for example, involved an extensive, coordinated programme of power system analysis intended to identify solutions to the significant security and operability challenges we face as a consequence of the changing generation position across Great Britain. These challenges were underlined by the event in South Australia on 28th September 2016, which involved the loss of supply to 850,000 customers and led to a regional Black Start. Similar to that in South Australia, the trend in northern Britain is towards high levels of non-synchronous intermittent generation.

Early in ED1 SPEN established that this 72 hour recovery from a black start event was no longer likely to be realistic given the closure of major thermal plant in Scotland and thereafter closure of thermal plants across the rest of GB. Following SPEN's engagement with the Transmission System Operator to update system recovery modelling and plans, and our joint engagement with relevant government agencies, we now understand that the National Risk Register will be updated to instruct relevant parties to plan for Black Start recovery that is more than 7 days.

DNOs' resilience to and recovery from Black Start events will be achieved through a combination of batteries and generators at substations, generators at control rooms and other key locations, and deployment of resilient operational response equipment (e.g. satellite phones). A number of these costs are directly impacted by the new requirement to be resilient to a black start event in excess of 7 days.

Given DNO costs to satisfy a 72 hour event were material, it is a reasonable expectation that the additional resilience required to recover from a 7 day event (being 4 additional days) will be material (for example resulting from the necessity for larger batteries or installing generators where batteries were previously sufficient). We estimate these costs will be in the range of £10m-£25m per DNO.

On the basis that this update from BEIS is expected early in 2018 it seems sensible to plan for these additional costs to be dealt with via an MPR. Government and industry changes to risk assessment are based on thorough assessments. It is important to address such risks, which are of national significance. If this update is delayed or subject to further levels of uncertainty then this could be dealt with effectively via an MPR that established a reopener (Category 2).

Issue 8: WPDs' Rail Electrification Costs (Category 1 MPR)

SPEN support an MPR of rail electrification costs to consider the material reduction in discrete costs resulting directly from a clear change in government policy. The review should also consider any other directly attributable discrete costs such as any Real Price Effects allowance.

Other DNOs have no allowances for rail electrification but have a Rail Electrification Reopener later in ED1 to allow them to seek to recover additional material costs resulting from changes in government policy.

As this reopener does not cover WPD and specifically any changes to their costs resulting from clear changes in government policy we believe that this is the only reasonable mechanism to avoid windfall gains for WPD and unnecessary costs for WPDs' customers.

A possible alternative would be to use the MPR to extend the Rail Electrification reopener to include WPD and for this to be symmetrical for them (similar to the scope of the UKPN Link Box Reopener in 2017). However, this should not be done in a way so as to significantly delay the repatriation of these unnecessary costs to customers and SPEN believe would not be in customer's best interests.

In this case there is a clear material reduction in discrete costs to WPD arising directly from a change in government policy and which should be returned to customers. This clearly satisfies the criteria for an MPR.

Issue 3: National Flood Resilience Review (Category 1 MPR)

There are new material costs to satisfy the important requirements communicated by government which are designed to protect all consumers from the material consequences of interruptions due to flooding.

SPEN's two distribution networks, SP Distribution (SPD) and SP Manweb (SPM), both achieved 100% compliance with the current flood resilience standard ENA ETR-138 (Energy Networks Association Engineering Technical Standard 138) by 2015. All the primary and grid substations identified as potentially at risk in 2009, were protected or confirmed as already resilient by 2015.

At the guidance of BEIS, DNOs have over the last 12 months been updating ETR-138 to a new higher standard. A final instruction from the UK government via BEIS is expected imminently to agree this change which will require 1 in 1000 year flood defences at a number of primary substations which previously needed a 1 in 100 year defence. Our initial assessment is that this might impact less than 10 SPEN primary substations, but this could increase to more than 100 if BEIS made relatively minor changes to the detail of the final decision.

In addition the relevant government environmental bodies[1] have refined their flood modelling since the ED1 price control process, which has resulted in an extension of the areas considered at risk from floods and therefore additional substations are now considered at risk. Improvement to these government agencies flood models has added 82 additional SPEN primary substations to the list of those considered at risk from flooding.

It is our understanding from the ETR-138 drafting process that it is not the expectation of BEIS that DNOs will fully comply with ETR-138 during the ED1 period but will work towards this applying a risk based approach to prioritisation of projects. If it becomes the expectation of Ofgem or BEIS that there is an ED1 output which is ongoing compliance with ETR-138, or full compliance with ETR-138 by the end of ED1, then material additional costs will arise. The changes will be made by various government bodies and these changes that satisfy the criteria of an MPR.

SPENs' current view is that this should be addressed by a MPR to fund these additional costs. However, if there remains insufficient clarity on the outputs during 2018, then this could be addressed by an MPR that established a reopener (Category 2).

For ED2 we would recommend that a revenue driver is established for these costs to reflect the ongoing impact of climate change and ongoing improvements to flood risk information from the relevant government agencies.

[1] Environment Agency in England, SEPA in Scotland and Natural Resources Wales

New Issue: Smart meters (other costs) – **(Category 1 MPR)**

We understand the position that Ofgem has set out in relation to intervention costs at service positions, but do not believe that the assessment considers the impact on other DNO costs from the smart meter programme delays. Consideration needs to be given to the delays to the achievement of projected DNO efficiencies driven by the new information from smart meters, and the capabilities of smart meters to replace the radio tele-switching service provided by DNOs.

All slow track DNOs allowed costs were subject to a smart metering efficiency stretch, based on the assumption that DNOs could deliver efficiencies from the improved information from smart meters. The assumptions on which these efficiencies were established assumed that the roll out of smart meters would be delivered much sooner than is now expected. This delay will affect all slow track DNOs and means that those efficiencies are no longer achievable.

The Radio Tele-Switch (RTS) service which is used by Suppliers to communicate off–peak charging instructions to 300,000 of their customers across GB is procured and provided by DNOs. If the smart metering programme was being delivered to the previously expected dates, and with the expected switching capabilities across all DNOs customers, then the RTS Service would have been discontinued in the middle of ED1. It now appears that these costs will continue for several years beyond those originally expected as to discontinue this service prior to suppliers having a reliable replacement in place will have an unacceptable impact on customers. This cost affects all DNOs but to a differing degree depending on the number of customers dependent on the RTS service in their area.

For SPEN we estimate these combined costs will be in the range £10-12m.

Where these increased costs are material for a particular DNO these should be considered within the scope of the ED-MPR process. We believe both SPD and SPM would satisfy this criteria based upon the ED1 smart metering efficiencies that were applied and as 50% of the actively switched radio tele-switches in the UK are used by SPEN customers.

Issue 2: Implementation of the European Clean Energy Package (Category 2 - MPR to establish new reopener mechanisms)

The Clean Energy Package proposes significant new obligations on DNOs and in particular an obligation to provide compensation for renewable generators if their output is constrained for any reason.

Whilst the final detail of the obligation will not be known until after regulations come into force in 2019, and this is translated into UK law and regulations, it is highly likely that the costs that will arise from these changes in government policy will be material.

Whilst the detail is uncertain there are a number of realistic outcomes that would result in DNOs facing costs of >£10m per annum.

This is an uncertainty that should be addressed by development of a reopener via an MPR.

Issue 1: Electric Vehicles (Category 3 - MPR to consider need for new reopener mechanisms)

There is a growing certainty that the rate of uptake and ultimate scale of EV adoption will have a major impact on electricity networks in the future. This impact will be a function of: the rate of uptake; charging technology; customer charging behaviour and; the level of EV charging management that can be implemented.

Despite this need for more investment in electricity infrastructure we estimate that this would be at a cost to the average consumer of about £20 per annum or 5 pence per day. Even after we add to this increased consumption, we believe this will result in a net benefit to consumers. Absent any change of taxation we believe households could potentially save over £1000 per annum from the switch from petrol or diesel to EV's, provided that a coordinated approach is taken and by involving Network Owners from the start.

We also must remember that Devolved Government's may have differing agendas, so a joint approach should be taken to meet the varying targets. For example, In January 2017, the Scottish Government consulted on its Draft Energy Strategy, which sets a new 2030 'all-energy' target for the equivalent of 50% of Scotland's heat, transport and electricity consumption to be supplied from renewable sources. Further, the recent announcement by the Scottish Government, which has outlined a commitment to phase out the need for Petrol and Diesel vehicles by 2032, is in contrast to the Westminster Government which has outlined a ban on the sale of new Petrol and Diesel vehicles from 2040. The reasons for this policy include the reduction of CO_2 emissions, whilst also the reduction of pollution (which engages important public health considerations).

The pace of adoption of technology, supported by economics and public acceptance could be far quicker than forecast. We may draw upon the lessons learned in relation to solar technology which the UK and many network operators had underestimated and were ultimately not prepared for. If DNOs are given increased local visibility of the likely penetration of EVs and the ratings of future charging points then proactive investment could be undertaken to prepare the network.

In 2017 a number of major car manufacturers announced significant increases in investment in development of electric cars, and a number of new market entrants revealed the scale of their investment in this area. In December 2017 the UK Government Committee on Climate Change estimated that[2]:

- 60% of new cars must be electric by 2030 to meet the UKs greenhouse targets;
- Over 29,000 charging locations needed across UK by 2030 to match EV demand;

Given the pace of change of technology, developing government policies to facilitate UK economic growth and deliver carbon targets, and the lessons learned from the market based roll out of smart metering, it is possible that DNOs could be asked to play a greater role in relation to EV changing roll out. If the Automated and Electric Vehicles Bill is enacted during 2018 and the Government seeks to use its new powers this may have a direct impact on DNO costs.

Given these factors SPEN believe that an MPR should establish a reopener mechanism to enable DNOs to respond to any new government requirements that emerge.

[2] http://www.bbc.co.uk/news/science-environment-42709763

Issue 6: Whole-system outcomes and the transition to Distribution System Operator (DSO); (Category 3 – MPR to consider establish new reopener mechanisms)

Government's expectations of DNOs' roles and responsibilities may change significantly during the remainder of ED1 to enable the transition to DSO, and may result in significant increased costs during ED1 for DNOs. A reopener mechanism may be justified in this area.

Issue 4: Resilience of Networks and Information Systems; (Category 4 – no MPR)

There are a number of new obligations on DNOs from both EU and UK legislation that are both known and under development. As such this clearly meets the criteria of costs arising from changes of government policy but is presently forecast to to fall short of the necessary materiality thresholds for an MPR or reopener.

Issue 7: Smart Metering (Intervention Costs); (Category 4 – No MPR)

We agree with the position set out by Ofgem that these costs do not satisfy the MPR criteria

Chapter 2, Question 2: Are there any other issues not covered by the MPR consultation which should be considered within the scope of the ED-MPR process?

SPEN do not believe that the assessment of Issue 7 (Smart Meters) fully considers the impact on all DNO costs from the smart meter programme delays. The detail of these additional costs and our view on the MPR consideration of these is also set out in the response to Chapter 2, Question 1 above.

New Issue: Smart meters (other costs) – **(Category 1 MPR)**

We understand the position that Ofgem has set out in relation to intervention costs at service positions, but do not believe that the assessment considers the impact on other DNO costs from the smart meter programme delays. Consideration needs to be given to the delays to the achievement of projected DNO efficiencies driven by the new information from smart meters, and the capabilities of smart meters to replace the radio tele-switching service provided by DNOs.

All slow track DNOs allowed costs were subject to a smart metering efficiency stretch, based on the assumption that DNOs could deliver efficiencies from the improved information from smart meters. The assumptions on which these efficiencies were established assumed that the roll out of smart meters would be delivered much sooner than is now expected. This delay will affect all slow track DNOs and means that those efficiencies are no longer achievable.

The Radio Tele-Switch (RTS) service which is used by Suppliers to communicate off–peak charging instructions to 300,000 of their customers across GB is procured and provided by DNOs. If the smart metering programme was being delivered to the previously expected dates, and with the expected switching capabilities across all DNOs customers, then the RTS Service would have been discontinued in the middle of ED1. It now appears that these costs will continue for several years beyond those originally expected as to discontinue this service prior to suppliers having a reliable replacement in place will have an unacceptable impact on customers. This cost affects all DNOs but to a differing degree depending on the number of customers dependent on the RTS service in their area.

For SPEN we estimate these combined costs will be in the range £10-12m.

Where these increased costs are material for a particular DNO these should be considered within the scope of the ED-MPR process. We believe both SPD and SPM would satisfy this criteria based upon the ED1 smart metering efficiencies that were applied and as 50% of the actively switched radio tele-switches in the UK are used by SPEN customers.

QUESTIONS RAISED IN CHAPTER 3

Chapter 3, Question 1: What are your views on a potential significant extension of scope to capture financial and incentive performance and design?

SPEN's position is that extending the scope of the MPR in such a significant way would have a materially detrimental effect on consumers in the long term due to the damaging impact this would have on trust and confidence in the regulatory system and future financing costs.

A decision to widen the scope of the MPR as contemplated by Option 3 would be a material departure from Ofgem's clear, unqualified statements that the MPR would not widened in the manner contemplated by Option 3. The very act of widening the MPR in this way would be materially damaging to investor confidence and increase the cost of capital in the longer run. Widening the scope of the MPR would weaken trust and confidence in Ofgem's regulatory regime and the commitments Ofgem make in future. This would not be in the interests of consumers. This is the case even if any "mini price review" did not ultimately result in a change to the position.

We set out our submission below under four headings:

1. Previous Ofgem assurances relating to the scope of the RIIO-ED1 MPR.
2. The need to maintain regulatory stability and trust and confidence in the regulatory system.
3. RIIO-T1 and RIIO-GD1 Mid-Period Review.
4. The price control has been extensively scrutinised.

(1) <u>Previous Ofgem assurances relating to the scope of the RIIO-ED1 MPR</u>

It is essential to maintain trust and confidence in the regulatory system. The objective of the RIIO framework is to provide a stable, predictable, long-term framework for investors, network operators and consumers.

In recognition of the move to an eight-year period, Ofgem included specific uncertainty mechanisms within the RIIO framework. This included provision for a MPR of outputs halfway through RIIO-ED1. As Ofgem very fairly recognise the scope of this was carefully defined in the Strategy Decision for RIIO-ED1 as follows:

> *"5.2 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.*
>
> *5.3. Other than in these circumstances, the mid-period review will not be used to adjust the output measures or output incentives that were set at the price control review."*[3]

[3] Ofgem, 'Strategy decision for the RIIO-ED1 electricity distribution price control - Uncertainty mechanisms' (4 March 2013), paragraphs 5.2 - 5.3

In the Strategy Decision Ofgem also state the following:

> "*The mid-period review is intended to cover external factors affecting the operation of the RIIO-ED1 price control.* ***It is not intended to be an opportunity for either Ofgem or the DNOs to conduct a mini price review****. As such we are keeping the scope of the mid-period review tight. The submission of business plans is the key opportunity for DNOs to propose the outputs they believe are required for RIIO-ED1. Stakeholders should provide their views on the DNOs plans and our proposals for each DNO at the appropriate stages of the review.* ***The mid-period review should not be seen as an opportunity to re-open decisions taken at the price control***." [4] (emphasis added)

In the December 2017 Consultation paper Ofgem acknowledge that the ED1-MPR was not designed to be an opportunity to re-open the price control through a mini price review.[5] If Ofgem decide to significantly extend the scope of the ED1-MPR under Option 3 then Ofgem would be acting against the legitimate expectations it has created through its numerous statements that the scope of the MPR would be tightly defined and that it would not be used to claw-back any gains that had been made.[6]

SPEN relied on these statements and proceeded on the basis that the ED1 determinations would not be re-opened when submitting its RIIO-ED1 business plans and more widely in dealing with RIIO-ED1. Any departure from the legitimate expectations Ofgem has created would need to be objectively justified in the circumstances. As discussed further below, SPEN's position is that the impact assessment attached to the Consultation does not provide a sufficient substantive justification for extending the scope of the MPR in the way suggested.

(2) The need to maintain regulatory stability and trust and confidence in the regulatory system

If Ofgem used the extension of the scope of the MPR to re-open critical elements of the RIIO-ED1 price control, this would be contrary to stakeholder expectations and could materially damage trust and confidence in the stability, predictability and certainty of Ofgem's framework. This is very likely to lead to a higher cost of capital. The critical need for regulatory stability is well understood and is a long standing principle. This is why Ofgem was well justified in setting out its expectations about the MPR at the Strategy Decision stage.

The approach Ofgem took at the Strategy Decision stage finds support from the Competition Commission's approach to such matters. For example, in its determination of Phoenix Natural Gas Ltd's price control dispute with the Northern Ireland Authority for Utility Regulation the Competition Commission (**CC**) stated as follows:

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[4] Ofgem, 'Strategy decision for the RIIO-ED1 electricity distribution price control - Uncertainty mechanisms' (4 March 2013), paragraph 5.19

[5] Consultation, page 4

[6] See for example, Ofgem, 'Handbook for implementing the RIIO model', (4 October 2010), paragraphs 11.14 and 11.17; and Ofgem, 'Strategy decision for the RIIO-ED1 electricity distribution price control - Uncertainty mechanisms' (4 March 2013), paragraphs 5.8 - 5.9

> "*In line with normal regulatory practice, our view is that any revision of previous regulatory determinations should be: well-reasoned, properly signalled, subject to fair and effective consultation, clear and understood, and, normally, forward-looking. …**Regulators are free to depart from previous decisions where appropriate in pursuit of their statutory objectives, but they should consider carefully whether their actions may be considered to lead to regulatory instability that will add to uncertainty in the industry**."* [7] *(emphasis added)*

Therefore whilst the CC recognised that regulators can revise previous regulatory determinations, they determined that revisions should generally only be forward-looking, clearly signalled and would require thorough consultation. The potential for regulatory stability is a critical factor to be determined. This is a high threshold against which any potential re-opening of the price control would need to be assessed.

The CC also considered the issue of having to balance the interests of current and future consumers, which is an important factor for Ofgem to consider. The CC stated as follows:

> "*While it is clear that prices to existing customers would reduce, we also note that there is a substantial risk that the consequences of such measures would be to reduce the willingness of investors to invest in future development of the gas network (and possibly other regulated sectors in Northern Ireland) and could increase the cost of capital applying. Therefore we consider that this could impede future gas network development which could otherwise create substantial future benefits for future customers, and could increase costs for current and future gas consumers*."[8]

The Monopolies and Mergers Commission (**MMC**) also considered the impact of regulatory instability in its report on the British Gas / Transco case:

> "*We consider that it is normally undesirable for previous regulatory price controls to be reopened. The RPI-X and periodic price control system does carry risks that allowed revenue may result, in some price control periods, in prices to customers which are either higher or lower than subsequently appear justified. It is right for regulators to seek to capture for customers some of the benefits of efficiency gains. It can also be appropriate to recover excess revenues for allowed capital investment which did not take place. However, we believe it is generally inappropriate to seek to claw back revenue allowed in a previous price control period, where a regulator has decided to change for the future the basis on which such revenue should be calculated, as would be the case in respect of this depreciation allowance*."[9]

Therefore even though extending the scope of the MPR might benefit consumers in the short-term, this has to be balanced against the longer-term risks of higher costs of capital which means customers will have to pay higher prices. This is not in the interest of consumers and would be inconsistent with Ofgem's duties.

[7] Competition Commission, 'Phoenix Natural Gas Limited price determination', (28 November 2012), paragraph 9.112
[8] Competition Commission, 'Phoenix Natural Gas Limited price determination', (28 November 2012), paragraph 37
[9] MMC, 'BG Plc: A report under the Gas Act 1986 on the restrictions of prices for gas transportation and storage services', (29 May 1997)

In the Consultation paper Ofgem acknowledge that this is the balancing exercise that must be carried out.[10] Ofgem include a draft impact assessment at Appendix 1. We are concerned that the impact assessment for Option 3 does not contain sufficient analysis of the negative impacts to allow respondents to meaningfully assess the very significant risks of an extension of the MPR, for example to the long term cost of capital.

(3) RIIO-T1 and RIIO-GD1 Mid-Period Review

Ofgem itself has considered these issues in a very similar context when it was consulting on whether to undertake a MPR for RIIO-T1 and GD1. As referred to in the impact assessment for Option 3, Ofgem undertook an impact assessment in response to consultation responses requesting the scope of the T1-MPR be widened. Ofgem's analysis in this context is also highly relevant when considering the ED-MPR.

In the decision paper for the T1 and GD1 MPR Ofgem acknowledges that extending the scope of the MPR could result in short term benefits as any sums clawed back would result in consumers having lower bills. However Ofgem concludes:

> *"However, in the long run we would expect a number of detrimental impacts to consumers to arise from taking such action. These impacts would primarily stem from the fact that the action to extend scope would go against the stated intention of the MPR to be focused on changes in output requirements alone. Moreover, we have been explicit in previous documents that we would not use the MPR to reopen more widely and that we did not want the MPR to result in two four-year price controls.* ***Widening the scope in this way would weaken confidence in our regulatory regime and the commitments that we make in future. These impacts would not be limited to just the transmission and gas distribution price controls but also other price controls we set for instance RIIO-ED which operates on a different regulatory timetable****."*[11] (emphasis added)

Ofgem also completed some impact calculations in this context:

> "*To illustrate the potential magnitude of this we have set out some illustrative impacts. Based on the current regulatory asset values in the 3 RIIO price controls (T1, GD1, ED1) a 10 basis point increase in the weighted average cost of capital would increase annual costs to consumers by around £65m per year. If such an effect were to last for the next price control period in each sector (i.e. the 8 year period), the discounted total value would amount to around £380m. If the weighted average cost of capital were to increase by 50 basis points, this discounted total value would amount to around £1.9bn. The magnitude of the impact and its duration would depend on what precise action we took so could be within or outside of the 10- 50 basis point illustration over 8 years but our expectation is that the effect would be significant and likely outweigh any short term savings*."[12]

[10] Consultation, paragraph 3.9
[11] Ofgem, 'Decision on a mid-period review for RIIO-T1 and GD1', (12 May 2016), page 56 paragraph 1.14
[12] Ofgem, 'Decision on a mid-period review for RIIO-T1 and GD1', (12 May 2016), paragraph 1.17

Ofgem ultimately concluded:

> "*We are therefore conscious of the need to balance the reduction of costs to consumers in the short term with the introduction of regulatory risk and uncertainty, which could ultimately lead to higher costs for consumers. Based on this,* ***we consider that the benefits of maintaining regulatory confidence and ensuring companies focus on the long term outweigh the potential short term benefits of widening the scope of MPR***." [13] (emphasis added)

Ofgem's approach to the T1 and GD1 MPR created a legitimate expectation that any MPR for ED1 would be assessed using the same criteria. All of the findings which Ofgem present in this impact assessment are also applicable when considering whether the scope of the ED-MPR should be widened. We agree with Ofgem's conclusions for RIIO-T1 and RIIO-GD1 that any potential short term benefits for consumers would be significantly outweighed by the benefits of ensuring regulatory confidence is not undermined.

(4) The price control has been extensively scrutinised

It is important context that the price control was subject to extensive public consultation and engagement between Ofgem, stakeholders such as electricity suppliers and others and the DNOs over a number of years. Following Ofgem's final decision for the slow-track DNOs, certain parts of the price control were the subject of two separate appeals to the CMA by British Gas Trading and Northern Powergrid. The CMA therefore has already extensively considered material parts of the RIIO-ED1 price control in 2015.

[13] Ofgem, 'Decision on a mid-period review for RIIO-T1 and GD1', (12 May 2016), paragraph 1.21

Chapter 3, question 2: Should Ofgem continue to develop Load Index outputs for RIIO-ED2 and reset the Time To Connect (TTC) targets, both as originally communicated as part of the ED1 process.

SPEN support this approach as it is consistent with the previous plans communicated by Ofgem.

Load Index: Development of the LI for ED2 will allow Ofgem and stakeholders to better understand the impact of the uptake of low carbon technologies and active network management solutions that result in higher network utilisation but enable a greater pace of low carbon transition.

TTC: SPEN believe that the TTC target setting process should be consistent with that originally used for ED1. To take account of different customer service and commercial practices between DNOs it should be a DNOs' own historic performance that set its targets. This approach means that targets and reporting are logically consistent and there is no need to apply interpretation to different DNOs reports or that standardised customer service or commercial practices are imposed.