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RIIO-2 Sector Specific Methodology - RWE Response

Dear RIIO Team,

RWE welcomes the opportunity to respond to the Ofgem consultation on “RIIO-2 Sector Specific Methodology” and the RIIO-2 Sector Annexes published on 18th December 2018 (the Consultation Documents). We are responding on behalf of RWE Supply and Trading GmbH and RWE Generation plc (RWE). This is a non-confidential response.

The RIIO-2 Sector Methodology comprises a comprehensive set of documents that are wide ranging but include specific elements that have profound implications for the electricity and gas markets. These include, for example, the consideration of whole system solutions, the role of the electricity system operator, electricity network access arrangements, gas baselines and the treatment of unsold capacity in the gas market (including substitution).

In certain areas such as gas baselines, Ofgem suggest that there is scope for the relevant licensee to undertake reviews. We note that such reviews have the potential to interact with other Ofgem initiatives including the electricity targeted charging review, the review of electricity network access and forward looking charges, gas charging, industry governance, behind the meter activities, smart metering and supplier hub arrangements. Given the scale and scope for these various initiatives there is a risk that they may overlap or have conflicting or competing outcomes. In addition, as a consequence of the work load the wider industry (outside the regulated companies) will find it difficult to engage in the price control related activities in a meaningful way.

There are a number of areas where Ofgem has not provided clarity of thinking. This relates in particular to separate consideration of the respective roles of system operators and the network owners, the way in which innovation should be incorporated into business as usual plans, the overlap of stakeholder engagement initiatives by the regulated companies and the potential for greater decentralisation of system operation in the electricity (and possibly gas) markets. Ofgem should update its thinking and provide some clarity on the prospective architecture for the whole system. In this context Ofgem should provide greater definition of the roles of the regulated companies in decentralised and decarbonised gas and electricity markets

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Our detailed comments to the sector methodology are included in to appendices this letter. Appendix 1 covers the overall sector methodology, Appendix 2 the RIIO-2 ESO Annex, Appendix 3, the RIIO-GD2 Gas Distribution Sector Annex, the Appendix 4 RIIO-GT2 Gas Transporter Sector Annex, and Appendix 5 the RIIO-ET2 Electricity Transmission Sector Methodology.

If you have any comments or wish to discuss the issues raised in this letter then please do not hesitate to contact me.

Yours faithfully

By email

Bill Reed, Market Development Manager

Appendix 1: Answers to the specific questions raised in the Consultation Document –

Cross-sector questions

Output categories questions

CSQ1. Do you have any view on our proposed approach for considering the extent to which a successful appeal has consequences, if any, on other components of the price control?

We agree with the proposed approach for considering the extent to which a successful appeal to the CMA has consequences for the price control settlement. It is important that the overall price control is based on a coherent regulatory approach.

However, we are concerned that a successful appeal could have wider consequences for the price control and could be a means to effectively reopen some elements of the price control framework. We would be concerned that as a result of a successful appeal key elements of the price control could be redesigned which could have wider consequences. Therefore we seek assurance that Ofgem will minimise the effects of a “mini price control review” resulting from a CMA decision on the wider electricity and gas markets.

CSQ2. Do you agree with our proposed three new output categories?

We agree with the proposed output categories, subject to ensuring that the relevant trade-offs between these are effectively managed. For example, a resilient network could be based on enhanced network investment (the traditional utility approach) or greater reliance of market solutions (favouring the decentralised needs of customers and network users). These inevitable trade-offs must be explicitly recognised and managed as part of the price control arrangements.

CSQ3. Are there any other outcomes currently not captured within the three output categories which we should consider including?

We do not believe that there are any other outcomes not captured within the three output categories.

CSQ4. Do you agree with our proposed overarching framework for licence obligations, price control deliverables and output delivery incentives?

We agree with the approach towards the price control deliverables particularly in relation to larger investments with considerable uncertainty as to whether they will go ahead.

With regard to output delivery incentives, we support the approach with regard to clearly defined and transparent delivery of specified services. We remain concerned that there may be opportunities for the network companies to optimise between service provision based on differing arrangements across incentive schemes. The design of the incentive schemes together with effective monitoring and reporting is therefore critical to the efficiency of the price controls.

CSQ5. Do you agree with our proposals to introduce dynamic and relative incentives, where appropriate? Are there any additional considerations not

captured in our proposed framework which you think we should take into account?

We agree that it is important to monitor performance levels and to seek enhancements throughout the price control process. For some services it may be appropriate to seek ongoing performance improvements through dynamic incentives while for others relative incentives through for example benchmarking activities may be appropriate.

CSQ6. Do you agree with our proposals to allow network operators to propose bespoke outputs, in collaboration with their User Groups/ Customer Challenge Groups?

We agree that network operators should be able to propose bespoke outputs where this is appropriate. Such bespoke outputs should be subject to certain qualifying criteria such as effective reporting and transparency. This will enable User Groups and Customer Challenge Groups to scrutinise performance and where appropriate seek revisions to such outputs where insufficient progress is being made or where performance is unsatisfactory.

CSQ7. When assessing proposals for bespoke financial ODIs, are there any additional considerations not captured which we should be taking into account?

On the specific subject of bespoke financial ODIs it is important to ensure that such initiatives are benchmarked on the financial parameters established under the price control. We would be concerned if the network companies were able to propose specific financial ODIs that undermined other elements of the price control or other Ofgem initiatives (such as the greater competition in network investments).

Enabling whole system solutions questions

CSQ8. Do you feel we have defined the problem correctly?

The section on whole system solutions in the consultation document together with initiatives elsewhere demonstrates that Ofgem are seeking to improve the delivery of regulated infrastructure in a more coordinated way. However, we are concerned that the approach adopted to date by Ofgem has resulted in initiatives that are fragmentary and disjointed. There are many interested stakeholders that are seeking to advance specific interests in this area including the network companies.

The price control element of the network companies is simply one element that needs to be taken into account when considering whole systems solutions.

In addressing the whole system, it would be appropriate to consider the key elements of market design that are required to deliver economic and efficient outcomes. For example, this could include whether a single GB system operator is required, with limited scope for local system operators or whether Distribution System operators would have a wider role, with a more limited role for the ESO. Likewise the electricity market currently operates at a GB level, but there has been considerable pressure to create local markets, effectively splitting the GB market into regional markets with the potential for different electricity prices in different locations. In this context, the various Ofgem electricity charging initiatives recognise that different users could pay different charges according to their locations but that this may have profound implications for who pays for the network overall.

As far as the price control arrangements are concerned the issues associated with market design and coordination requires resolution to ensure that the roles of the network companies in terms of output delivery are well defined. Since the price controls will remain in place for a number of years the definition of these roles has consequences for the delivery of whole systems outcomes.

CSQ9. What views do you have on our proposed approach to adopt a narrow focus for whole systems in the RIIO-2 price control, as set out above?

We support the proposed approach in relation to a narrow focus for whole systems as part of RIIO-2. This is a pragmatic approach given the legislative and regulatory framework. However as noted above we believe that this decision should be taken in the context of the defined roles of the key players and the wider implications for the GB electricity market design.

CSQ10. Where might there be benefits through adopting a broader scope for some mechanisms? Please provide evidence.

Ofgem identify a number of areas that could be included in a wider definition of whole system, including activities “behind the meter”. We note that Ofgem initiatives with regard to network charging touch on the “behind the meter” issues. For example, “final demand” may need to be distinguished from generation activities such as storage on sites “behind the meter” for the purpose of recovering network company’s costs (residual charging). Therefore “behind the meter” activities should fall within the scope of the price control regime since it is intrinsic to the recovery of network revenues.

CSQ11. Do you have reasons and evidence to support or reject any of the possible mechanisms outlined in this chapter? Do you have views on how they should be designed to protect the interests of consumers?

Whole systems solutions should be determined against overall economic and efficiency criteria. In this context it is important that the roles of the market actors such as system operators, transmission companies, distribution activities and all relevant stakeholders (e.g. electricity generation and supply activities) are considered together to ensure that whole systems are enhanced.

The requirement for network investment (e.g. at the transmission level) should be assessed against market based solutions (e.g. by managing constraints at the distribution level). This issue should be considered as part of market design and recognised in the network planning arrangements.

CSQ12. Which of the possible mechanisms we have outlined above could pose regulatory risk, such as additionality payments or incentivising the wrong behaviour?

The shareholders of each network company will have a view on future earning potential and the risks associated with company prospects. We would be concerned if the mechanisms outlined in the consultation document significantly increased the regulatory risks (and the cost of finance) associated with the network companies.

CSQ13. Are there obstacles to transferring revenues between networks that disincentivise those networks from using a coordinated solution (please give details and suggest any changes or solutions)?

We would be concerned if any process for enabling revenue transfer was seen as increasing the risk of the network companies and therefore increasing the overall cost of capital.

The role of the system operators in determining efficient levels of investment in network assets and services is crucial in delivering a coordinated solution. Consequently there should be limited scope for “transfer” of revenues between price controlled players if the ex-ante market design is clearly defined.

We would be concerned if historic decisions by the system operators have effectively resulted in revenue transfers without effective regulatory oversight. This may be evident in transfers from existing market players to new entrants in the provision of balancing services through explicit actions of the GB system operator. New arrangements may favour distributed resources over transmission connected resources (e.g. lower costs for service provision). While it has encouraged new providers there is concern about the level playing field for all market actors in this type of intervention. Consequently ex ante design of markets is a critical element that will facilitate whole system solutions without the need for explicit “revenue transfers”.

CSQ14. Can you recommend approaches that would better balance financial incentives between networks to enable whole system solutions?

A focus on efficient outcomes would ensure that the optimum balance of financial incentives between networks to enable whole system solutions is delivered. This focus should be driven by the GB system operator and regional system operators working cooperatively together with relevant stakeholders to deliver markets that provide economic and efficient whole systems solutions. For example, system operators procure “services” from market participants including network asset owners (in the form of network investment) to resolve constraints in an economic and efficient manner.

CSQ15. Are there other mechanisms that we have not identified that we should consider (please give details)?

We do not have a view on other mechanisms to deliver whole systems outcomes. However, a focus on the ex ante market design to deliver whole systems would be beneficial at the start of the price control process so that roles and responsibilities are clearly defined. This should focus particularly on the boundary issues for the national ESO and regional distribution system operators.

CSQ16. Are there any additional framework-level whole system barriers or unlocked benefits, and if so, any price control mechanisms to address these?

We do not have a view on any additional framework-level whole system barriers or unlocked benefits and any price control mechanisms to address these.

CSQ17. Are there any sector specific whole system barriers or unlocked benefits, and if so, any sector specific price control mechanisms to address these?

We do not have a view on any sector specific whole system barriers or unlocked benefits, and any sector specific price control mechanisms to address these.

CSQ18. Which of the proposed mechanisms would be most suitable in circumstances where a broader definition of whole system is likely to deliver benefits to network consumers?

We support a narrow focus on whole systems solution in the context of the network price controls (the whole system comprises both Transmission and Distribution networks). A wider review of the energy market design is required to encompass a wider definition of whole systems (for example to include heat).

Asset resilience questions

CSQ19. Do you agree with our proposals to use monetised risk as the primary basis for network companies to justify their investment proposals for their asset management activities?

We agree that the network companies and Ofgem should develop a robust methodology for assessing the potential risk of asset failure as part of the price control process. We believe that this methodology should be open and transparent and subject to wider scrutiny to determine whether it is appropriate for determining asset management activities. The methodology should then form the basis for establishing the rewards available to the network companies as part of the price control.

Ofgem's proposed approach in terms of the "Network asset Risk Metric" may be an appropriate basis for the price control methodology. However, the approach needs further development and justification. We would like to see how it would work in the context of real world examples to enable us to determine if this approach is practical and simple enough for the network companies in relation to effective asset management.

CSQ20. Do you agree with our proposals to define outputs for all sectors using a relative measure of risk?

The accuracy of a "relative measure of risk" depends on the assessment process that determines the risks of failure without intervention and the risk as a result of the intervention during the price control period. Companies may be able to outperform if they determine both of these levels of risk. It is critical therefore that the measures are subject to a robust and reliable technical assessment process, with the possibility of some level of external scrutiny to determine whether the risk levels are set appropriately.

CSQ21. Do you agree with our proposals for defining outputs using a long-term measure of the monetised risk benefit delivered through companies' investments?

For long lived assets it is appropriate to assess proposals based on a long term assessment of the potential risks of failure. We would note that overemphasising intervention may in itself increase failure risk or outage costs, and this must be taken into account in any methodology that is developed in this area.

CSQ22. Do you agree with our proposed approach to setting allowances and outputs?

We agree with the approach to setting allowances and outputs, subject to ensuring that the assessment of monetised risk is a robust and practical approach for the price control period. In some cases it may be appropriate to consider the risks of alternative approaches towards asset maintenance where for example it may be appropriate to defer or delay intervention (if there is uncertainty about the requirements for an asset) or invest in entirely new assets or consider alternative means to managing risk (such as load management) in determining an appropriate course of action.

CSQ23. Do you have views on the proposed options for the funding of work programme spanning across price control periods?

The price control arrangements introduce the risk of interruption in funding for projects which may span price control periods. It is essential therefore that funding mechanisms reflect the long term nature of projects and ensure continuity of funding. In addition, the funding arrangements for subsequent price control periods will not be known at the start of the RIIO-2 period. In this context it would, therefore, be more appropriate to consider Option 2 and allow for funding in RIIO-2 of work on projects which may be delivered in the next price control period.

CSQ24. Do you have any views on the options and proposals for dealing with deviation of delivery from output targets?

The network companies should be appropriately incentivised to deliver the expected outcomes for the price control period. It is unclear at this stage whether the proposed NARMs approach will deliver an efficient incentive regime, particularly if there is an asymmetry or risk (i.e. the downsides significantly outweigh the upsides or vice versa). Further information is required on the proposed methodology to enable stakeholders to understand whether the NARMs-related penalty regime is an appropriate risk framework.

CSQ25. Do you have any views on the interaction of the NARM mechanism with other funding mechanisms?

It is essential that the NARM mechanism does not result in double funding of the network company projects as part of the price control.

CSQ26. Do you have any views on ring-fencing of certain projects and activities with separate funding and PCDs? Do you have any views on the type of project or activity that might be ring-fenced for these purposes?

It would seem appropriate to ring-fence certain projects and activities, with separate funding and PCDs for these projects. These projects should meet specific conditions or criteria in order to be considered separately in the price control arrangements.

Workforce resilience question

CSQ27. Where companies include a sustainable workforce strategy as part of their Business Plans, what measures do you think could be established to hold companies to account for delivering these plans, without distorting optimal resourcing decisions?

It is essential that the network companies invest in and maintain a workforce that is capable of delivering the price control outputs. However, a robust workforce strategy should be part of the normal day to day activities of the network companies and does not need to be subject to additional regulatory oversight.

Physical security questions

CSQ28. Do you agree with maintaining the existing scope of costs that fall under Physical Security, i.e. costs associated with the PSUP works mandated by government? Please explain your reasons and suggest alternative definitions you believe should be considered.

We agree with maintaining the existing scope of costs that fall under Physical Security since these are mandatory costs for the network companies.

CSQ29. Do you agree with our proposed approach of ex ante allowances for PSUP works mandated by government? Please explain your reasons and suggest alternative approaches you believe should be considered.

We agree that the proposed approach of ex ante allowances for PSUP works mandated by government is an appropriate and pragmatic means of dealing with these costs.

CSQ30. Do you agree with our proposal to include a reopener mechanism to deal with costs associated with changes in investment required due to government-mandated changes to the PSUP?

We agree with a reopener mechanism to deal with costs associated with changes in investment required due to government-mandated changes to the PSUP

CSQ31. We would also welcome views on the frequency that is required for any reopener, e.g. should there be one window for applications during RIIO-2 and, if so, when?

It is difficult to determine the frequency that is required for any reopener given the uncertainty associated with any such Government intervention. It would be appropriate for Ofgem to allow for a reopener in the specified circumstances associated with Government mandated physical security initiatives and to consult on the timing such a reopener if such a circumstance arose.

Cyber resilience questions

CSQ32. Do you agree with the scope of costs that are proposed to fall under cyber resilience, ie costs for cyber resilience which are (1) incurred as a direct result of the introduction of the NIS Regulations, and (2) above 'business-as-usual' activities? Please explain your reasons and suggest further or alternative costs you believe should be considered.

We agree with the scope of costs that are proposed to fall under cyber resilience where they explicitly relate to these costs, are incurred as a direct result of the introduction of the NIS Regulations and do not form costs that are currently funded through the price control arrangements. It should be for the network companies to identify such costs and seek appropriate funding under these arrangements. As part of their submissions, the network companies should make the case that the costs are not part of funded activities.

CSQ33. Do you agree with our proposed approach of ex ante 'use-it or lose-it' allowances? Please explain your reasons and suggest alternative approaches you believe should be considered.

The network companies are required to comply with the NIS regulations and it is their responsibility to submit appropriate plans to the competent authority. It is these plans which should be funded through specific ex ante output measures as part of the price control. Those companies that do not submit plans in time could be subject to a reopener mechanism in relation to these plans, but this should be in exception circumstances.

We do not understand the need for specific cyber allowances over and above the business plan submissions from the network companies. We expect that the network companies acting as reasonable and prudent operators will make appropriate allowance for investment in cyber security as part of their wider price control submissions. Consequently the costs associated with efficient investment in cyber security should

already be reflected in these costs. There is no need therefore for additional allowances or mechanism associated with cyber resilience.

CSQ34. Do you agree with our proposal to include a re-opener mechanism for cyber resilience costs? Please also provide your views on the design of the re-opener mechanism.

We do not agree with the proposal to provide a re-opener mechanism for cyber resilience costs. The network companies acting as reasonable and prudent operators should have already made allowance for these costs in their business plan submissions. Therefore a specific provision for cyber resilience costs would potentially result in under provision for these costs in the business plans or over reward the companies with respect to these costs.

Real price effects questions

We note Ofgem's observations on uncertainty mechanisms within the price control. These mechanisms should be linked to key triggers or milestones in an approvals process that indicate the commitment of the network companies to proceed with the relevant investments. These triggers should be subject to regulatory oversight by ensuring that the network companies have fully justified a decision to proceed to the next stage of a project. This may require network companies to secure the appropriate levels of user commitment.

CSQ35. Do you have any views on our proposed factors to consider in deciding on appropriate input price indices? Do you have any evidence justifying the need for RPEs and any initial views on appropriate price indices?

Price indexation has a role to play in the price control where there is sufficient certainty on the cost inputs over the business plan period. This could include, for example, allowances for indexation of the costs of plant and equipment associated with network investment such as cables or transformers.

CSQ36. Do you agree with our initial views to retain notional cost structures in RIIO-2, where this is an option?

We agree with the initial views to retain notional cost structures in RIIO-2, where this is an option

CSQ37. Do you agree with our initial views to update allowances for RPEs annually and to include a forecast of RPEs in allowances? Do you have any other comments on the implementation of RPE indexation?

We agree with the initial views to update allowances for RPEs annually and to include a forecast of RPEs in allowances.

Ongoing efficiency questions

CSQ38. Do you agree with our proposal to use the EU KLEMS dataset to assess UK productivity trends? What other sources of evidence could we use?

We have no views on this matter.

Managing the risk of asset stranding questions

CSQ39. Do you think there is a need for a utilisation incentive at the sectoral level? If so, how do you think the incentive would operate coherently with the proposed RIIO-2 price control framework for that sector?

We do not believe that there is a need for a utilisation incentive at the sectoral level. Indeed such an incentive could be counter-productive and lead to inefficient utilisation of the network when considered from a whole systems perspective.

Furthermore we are concerned that Ofgem perceive a lower use of existing assets is somehow a measure of under-utilisation. It is important that the network companies maintain an efficient system that allows for the effective operation of the wider energy markets (both gas and electricity). For example, the ability of the energy markets to operate in different ways is facilitated by the maintenance of the gas and electricity networks with their current levels of capacity. This allows, for example for the flexing of gas imports at different locations and for offtakes to fluctuate significantly (for example in response to differing levels of renewable generation in the electricity market). We see the provision of the current levels of network capacity as an important element that enables efficient operation of the GB electricity market.

CSQ40. Do you have any views on our direction of travel with regard to anticipatory investment?

We agree that the network companies must make the case for future investments. This should be on the basis of clear evidence of future needs backed by appropriate levels of user commitment.

CSQ41. What type of projects may be appropriate for a risk-sharing approach?

Further work is required to determine the appropriate level of risk sharing associated with projects associated with network investment. We note that Ofgem are currently considering approaches that would enable third parties to be more actively involved in "significant" network investments on the basis of perceived lower cost to customers. Greater risk sharing from existing utility companies may deliver some of these benefits but may also compete with third party involvement in network investment.

CSQ42. How can we best facilitate risk-sharing approaches for high-value anticipatory investments?

We note Ofgem views on risk sharing for high value anticipatory investment as set out in the consultation document. It is important that appropriate levels of user commitment are considered as part of this approach to ensure that users are not encouraged to free ride on anticipatory investments.

CSQ43. How can we guard against network companies proposing risk-sharing arrangements for project they may have undertaken as business as usual?

A framework is required for the network companies to provide the evidence that justifies a risk sharing arrangement for network investment by comparison with the counterfactual (i.e. business as usual). This framework should provide an opportunity for stakeholder involvement should require user commitment in relation to the projects and should be subject to overall regulatory approval.

Innovation questions

CSQ44. Do you agree with our proposals to encourage more innovation as BAU?

Innovation should form part of the business as usual plans of the network companies. Innovation initiatives should not compete with efficient market solutions. The network companies must describe the compatibility of their approaches towards innovation with the existing market structures.

We are concerned that the network companies will foreclose efficient markets through the approach towards innovation. This could include, for example, provision of balancing services through network investment which competes with existing market providers. Intervention by network companies may also involve direct relationships with customers or generators with detrimental impacts on suppliers or other intermediaries.

CSQ45. Do you agree with our proposals to remove the IRM for RIIO-2?

We agree with the proposal to remove the IRM for RIIO-2. The commercial delivery of the technologies identified during the innovation process should be determined by the competitive processes in the relevant market (i.e. if the technology is sufficiently attractive to ensure delivery by market players without the need for any further funding).

CSQ46. Do you agree with our proposals to introduce a new network innovation funding pot, in place of the Network Innovation Competition, that will have a sharper focus on strategic energy system transition challenges?

We do not believe that the case for a new network innovation funding pot has been made in the consultation documents. As stated earlier, innovation should form part of the business as usual plans of the network companies, and they should be encouraged to find new ways of working that deliver consumer benefits by investing in their own research and development programmes.

The innovation funding process to date has resulted in projects that could distort existing markets and impact on wider stakeholders. There is currently wide scope for innovation to meet the energy system challenges and considerable potential for new entrants to the market to deliver consumer benefits (for example, associated with small scale distributed energy and storage facilities). The specific innovation funding driven by the network companies may foreclose opportunities for avoided network investment.

CSQ47. Do you have any views on our proposals for raising innovation funds?

We are unconvinced that funding innovation through use of system charges is an effective deployment of customer resources. While we see a role for network companies in facilitating the challenges associated with the energy transition, it should be for Government, associated institutions and commercial organisations to develop relevant research programmes for investment in innovation. The direct participation of the network companies in these research programmes could form part of their business as usual activities.

CSQ48. Do you think there is a continued need for the NIA within RIIO-2? In consultation responses, we would welcome information about what projects NIA may be used to fund, why these could not be funded through totex allowances and what the benefits of these projects would be.

We do not think that there is a continued need for the NIA within RIIO-2. Innovation funding should be part of the business as usual activities of the network companies.

CSQ49. If we were to retain the NIA, what measures could be introduced to better track the benefits delivered?

The NIA should not be retained as part of the new price control regime.

CSQ50. Do you agree with our proposals for electricity distribution companies prior to the commencement of RIIO-ED2?

While we remain of the view that network innovation funding should form part of normal business as usual activities of the network companies, we do not have any specific views on the proposals for electricity distribution companies prior to the commencement of RIIO-ED2.

Competition questions

CSQ51. Have we set out an appropriate set of models for both late and early competition to explore further?

We note Ofgem's views on models for late and early completion as set out in the consultation document. These models should be set against a clearly defined and coherent ex ante market design where the roles and responsibilities of the various market players are set out. In this context "competition" in the delivery of network investments should form a normal part of business as usual for network companies, whether in the form of competitive tenders or in the form of third party investment in major projects.

In the consultation document Ofgem identifies "flexibility markets operated by a DSO" as part of the "early" competition. We are unclear as to what this means in practice. Flexibility markets should form an enduring solution to network operation, whether it involves the GB ESO or the distribution businesses. Therefore this aspect of "competition" is neither exceptional or unusual but should be part of business as usual for the network companies.

CSQ52. Do you agree with the proposed criteria we have set out for assessing the suitability of late competition models? Would you suggest any other criteria, and if so, why?

We agree that the late competition models should be associated with new, separable and high value criteria for network investment.

CSQ53. Do you have any views on the costs and benefits we have used for our draft impact assessment on late competition?

We remain concerned that the competition elements are based on access to a lower cost of capital for specific project funding. The existing network companies should be able to access such funding and we are unclear as to how third parties will deliver the projects on a lower cost basis unless they are somehow insulated from the risks of project delivery (e.g. late delivery or delayed delivery or project milestones).

CSQ54. Are there any considerations for a specific sector we should include in our IA?

We do not have any views on the sector specific considerations. However, we note that large scale infrastructure projects are always at risk of delays and costs overruns (e.g. Crossrail, Hinckley Point power station, Beaulieu Denny transmission line, West Coast HVDC interconnector etc.). Any competition process must take these risks into account.

CSQ55. What are your views on the potential issues we have raised in relation to early competition? How would you propose mitigating any issues and why? Are there additional issues you would raise?

The network companies should be able to demonstrate the cost effectiveness of alternative solutions associated with projects that fall into the early competition definition.

CSQ56. Are there other potential drawbacks of early competition?

The costs associated with any changes in specification or delivery requirements need to be taken into account in developing an early completion solution.

CSQ57. Do you consider that there are any existing examples of early competition (including international examples or examples from other sectors) which demonstrate models of early competition that could generate consumer benefit in the GB context?

There are many examples of “early competition” from other infrastructure sectors and in the energy industry that should be taken into account in the assessment of “early competition”. This includes for example, rail infrastructure, Crossrail, nuclear power stations around the world, GB transmission lines such as the Beaulieu Denny transmission line and the West Coast HVDC interconnector.

CSQ58. What are your views on the advantages and disadvantages of the high-level approaches to early competition outlined? How would you recommend mitigating any disadvantages?

We do not have any specific views on the advantages or disadvantages of the “early competition” models, though we would note that the existing network companies have significantly greater experience of managing network investment than some other potential infrastructure providers.

CSQ59. Do you have any views on the potential criteria for identifying projects for early competition discussed above? Would you suggest any other criteria, and if so, why?

We do not have any views on the potential criteria for identifying projects for early competition discussed at this stage in the consultation process.

CSQ60. What are your views on the advantages and disadvantages of the high-level approaches to early competition outlined? How would you recommend mitigating any disadvantages?

We do not have any views the advantages and disadvantages of the high-level approaches to early competition outlined at this stage in the consultation process.

CSQ61. Do you agree with the criteria we have set out for assessing who should run competitions? Based on these criteria, which institution do you consider is best placed to run early and late competitions?

We agree with the criteria set out for assessing who should run competitions. The GB ESO has the expertise and technical capability to perform a role in relation to the competitive provision of both electricity transmission and distribution investment. We are unconvinced, however, that the ESO should be the direct procurement body that awards

and manages the relevant contracts since it does not have an asset backed balance sheet. Further work is required to determine the body that is responsible for the relevant contracts (ie the counterparty for the contracts).

The example cited in the consultation document with respect to flexibility contracts awarded by network companies to avoid network investment highlights some of the issues associated with market design that we have noted elsewhere in this response to the consultation document. Such flexibility contracts may in effect create local balancing markets or foreclose the wider electricity market. It is essential therefore that the roles and responsibilities of the key actors in the electricity market are well defined as part of a coherent whole system market design.

CSQ62. Do you agree with how we have described native competition? Do you agree we should explore the proposals described above to enhance the use of native competition? Are there any other aspects we should consider?

On the issue of “native competition” we believe that the role of the network companies in the overall market design is a key element in determining the levels of competition. For example, the role of system operation at a distribution level, associated with definition of network access rights and the depth of connections are essential features in determining efficient levels of investment.

CSQ63. How do you think competition undertaken by network companies should be incentivised? Is the use of totex the best approach? Will this ensure a level playing field between network and non-network solutions including the deployment of flexibility services?

The incentives for competition relate to the overall efficiency of the network companies in delivering effective outcomes for consumers. The price control arrangements should determine the extent to which existing network companies are delivering outcomes that are equivalent to a competitive solutions. This an important benchmark in assessing whether there are further requirements for competition.

We do not see any evidence in the Consultation Document that the existing price control arrangements are not capable of delivering outcomes that are equivalent to a competitive solution at this stage in the consultation process.

CSQ64. What views do you have on an approach where totex allowances would be based on costs revealed through competition, with a margin or fee for the competition-running entity?

We do not have any views on an approach where totex allowances would be based on costs revealed through competition at this stage of the consultation.

CSQ65. Do you think the ESO could have a role to play in facilitating competition in the gas sectors?

We do not see a role for the ESO in facilitating competition in the gas sectors. However, we do see a role for a more independent gas system operator working alongside the GB ESO in delivering competitive whole system solutions.

Business Plan and totex incentives questions

We do not have any views on questions CSQ66 to CSQ81 at this stage in the consultation process.

Ensuring fair returns questions

We do not have any views on questions CSQ82 to CSQ90 at this stage in the consultation process.

RIIO-2 Achieving a reasonable balance questions

We do not have any views on question CSQ91 to CSQ99 at this stage in the consultation process.

Preliminary impact assessment questions

We do not have any views on questions CSQ100 to CSQ103 at this stage in the consultation process.

Finance questions

We do not have any views on questions FQ1 to FQ37 at this stage in the consultation process.

Appendix 2: Answers to the specific questions raised in the Consultation Document –

Electricity system operator questions

ESO roles and principles questions

ESOQ1. Do you agree with our proposal to maintain the current roles and principles framework for RIIIO-2?

The ESO plays a critical role in the GB electricity market. The principles-based approach helps to determine the overall framework in which the ESO operates and should be maintained.

The GB energy market design requires detailed consideration as part of the transition to a low carbon, decentralised energy system. In this context, the role and responsibilities of the GB ESO in the overall system architecture should be reviewed. This could include:

- The extent to which the GB ESO undertakes activities that encompass other networks including distribution networks where, for example, these could be greater coordination and cooperation between the operation of higher voltage distribution assets and the transmission networks (such as the 132kV network in England and Wales);
- The role of the GB ESO in resolving system constraints including those which occur on the distribution network;
- The role for distribution system operators requires definition, and the extent to which they provide either residual roles (if the ESO has greater responsibility) or local roles (such as resolving constraint issues at lower voltages in the distribution networks);
- The role of the GB ESO in setting a network charges in a coordinated, economic and efficient way, with coherent locational signals for network investment based on marginal costs;
- The extent to which third parties may be able to undertake some roles under the umbrella of the GB system operator such as the code modifications process and capacity market administration. The current GB ESO licence provisions could be utilised to provide for these roles (as it does, for example with the Balancing and Settlement Code); and
- The relationship between the GB ESO and the GB gas system operator requires detailed thought since coordination between these bodies may become increasingly important. For example, the GB ESO may increasingly rely on the provision of gas market flexibility to ensure fluctuations in output from intermittent generators can be effectively managed.

ESOQ2. Do you agree with our proposals to keep the ESO's code administration, EMR delivery body, data administration, and revenue collection functions in place for RIIIO-2? Do you believe that any of these functions (or any other functions) should be opened up to competition, either now or in future?

We note Ofgem's proposal proposals to keep the ESO's code administration, EMR delivery body, data administration, and revenue collection functions in place for RIIIO-2. However, Ofgem are currently reviewing the Code governance arrangements. As part of this the direct responsibility of the ESO in providing the relevant administrative services should be reviewed. This could include the possibility that a third party provides

administrative support to the ESO. This could be on the basis of the provision of code administration at arms-length as is the case under the Balance and Settlement Code.

ESOQ3. Do you consider the ESO is best-placed to run early and late competitions?

The ESO has a key role to play in the procurement of competitive investment in the GB electricity networks since it currently has relevant expertise and experience. We are unconvinced, however, that the ESO should be the direct procurement body that awards and manages the relevant contracts since it does not have an asset backed balance sheet. Further work is required to determine the body that is responsible for the relevant contracts (i.e. the counterparty for the contracts).

Price control process questions

ESOQ4. Do you agree with our proposal to move to a two-year Business Planning cycled price control process for the ESO? If not, please outline your preferred alternative, noting any key features (e.g. uncertainty mechanisms or re-openers) that should be included.

Given that it will take time to establish properly an independent GB ESO it is appropriate to apply a shorter term horizon to the ESO price control period. The duration of the relevant incentives under the scheme should also be kept under review.

Under the ESO price control it is difficult to separate the outcomes that relate to business as usual and the outcomes that relate to performance that exceeds these expectations. We remain concerned that the ESO may set outcomes that are relatively easy to meet in determining the levels of out-performance. Some of the current incentives seem relatively easy to meet and do not necessarily result in the levels of enhanced performance that we would expect.

ESOQ5. What stakeholder engagement mechanisms should be put in place for the ESO's Business Planning and ongoing scrutiny of its performance? Do you agree with our proposal to maintain, and build upon, the role of the Performance Panel?

We support an enhanced framework of stakeholder engagement from the GB system operator. However, we note that these new engagement processes require a significant commitment from stakeholders to remain engaged. With limited resources available across the industry it is difficult for all stakeholders to contribute effectively at the level required to determine fully whether the ESO is out performing its targets.

The performance panel is a step forward in assessing the effectiveness of the ESO in delivering the business plan. However, the Panel can only effectively contribute if maintains a sufficient level of expertise (particularly in relation to the function of the GB energy market at a detailed level).

There remains a concern about information asymmetry which may hinder stakeholder engagement and the work of the performance panel. This may occur through, for example, through concentration on performance measures that are not always relevant to the effective and efficient delivery of ESO functions (e.g. equal weight for certain measures such a stakeholder engagement may take attention from other areas of such effective procurement of balancing services). The key areas for focus in terms of the ESO price control in the short term are IT delivery, the provision of new balancing markets and improvements in code administration.

ESO output and incentives questions

ESOQ6. Do you agree with our proposed approach of using evaluative, ex-ante incentives arrangements for the ESO?

We agree that an evaluative ex ante approach represents a pragmatic approach towards the towards the incentive arrangements for the ESO.

ESOQ7. Do you agree that we should continue to apply a single 'pot' of incentives to the ESO, and that this should be a symmetrical positive/negative amount? If not, why not?

We agree that there should be an appropriate single symmetrical performance incentive for the GB ESO. However, we note that in evaluating performance there are a number of components that contribute to the overall outcome. These components should be subject to appropriate levels of measurement and evaluation. Furthermore we note that the ability of the ESO to manage incentives should be taken into account so that there is limited scope for the ESO to manage performance between the different drivers. For example constraint management and system balancing are intrinsically linked elements.

The overall award of incentive payments should be subject to regulatory scrutiny and oversight so that the ESO is rewarded for a level of performance that exceeds expectations and or penalised if the overall level of performance fails to meet the required standards.

ESO cost assessment questions

ESOQ8. Do you agree with our proposed approach to assessing the costs of the ESO under RIIO-2? Do you think we should assess costs on an activity-by-activity basis? How would you go about defining the activity categories? Are there alternative approaches we should consider?

We agree with an activity based approach towards assessing the costs of the ESO under RIIO-2. It is important that the role of the ESO is well understood in defining the activities that must be performed. In this context the activities should be clearly specified alongside the proposed deliverables or expected outcomes

The ESO should be held to account for the delivery of significant new initiatives such as improved market information systems, improving dispatch arrangements, Project TERRE, reserve and frequency markets, reactive markets and enhanced black start. Key milestones should be identified and the ESO should report regularly on progress.

ESOQ9. Do you consider the types of cost assessment activities we outline in this chapter are the right ones? Are there additional activities you think we should consider?

We note the characterisation of activities in the consultation document.

The activities should be weighted in importance in relation to the total forecast expenditure in each area. Measures should be established that are proportionate to the activity undertaken and the relative importance.

The principal focus for the ESO should be on "primary" activities related to the main elements of spend including operating the system in real time and facilitating and running key electricity markets. For these activities it is essential that there is detailed regulatory oversight of performance.

Within the principal activities there may be key components for cost control related balancing service provision, managing frequency, provision of reserve, effective cross border reserve management and system resilience (including black start). The ESO should establish milestones and benchmarks related to establishing and maintaining markets, system availability (including IT systems), timeliness of critical market information and IT delivery.

For key industry initiatives it is essential that the ESO establishes and maintains project plans for delivery that are open and transparent. The ESO must be held to account for failure to deliver key elements of market infrastructure such as despatch systems, systems that interface with balancing service providers and associated settlement systems.

Other activities are “secondary” in nature and relate to effective administration such as network planning, access and transmission charging, code administration, delivery body for EMR, developing a strategy for innovation and future scenario production. Measures should be developed for these activities that relate to the effectiveness of the administration such as getting it right first time, responding to stakeholders in a timely manner and effective delivery of the relevant service.

ESO finance questions

ESOQ10. Do you agree with our proposed remuneration model for the ESO under RIIO-2? Do you think it provides the right incentives for the ESO to deliver value for money for consumers and the energy system? Are there other models you think are better suited?

We agree that the GB ESO should be effectively financed and financeable. However, as Ofgem note this is essentially an “idiosyncratic organisation”. Therefore it is appropriate that the overhead costs of operating and managing the electricity system and provision of effective administration are open and transparent and form part of the cost pass through approach.

In this context the price control arrangements should be based on an assessment of the efficient overheads required to fulfil the functions that are undertaken. Overheads should therefore be assigned to particular activities. This should include assignment of ESO corporate overheads across the various functions and activities.

ESOQ11. Are there any risks associated with our proposed remuneration model that you do not think have been effectively captured and addressed? Do you think that we should put in place any of the mechanisms intended to provide additional security to the ESO outlined in this chapter – e.g. parent company guarantee, insurance premium, industry escrow or capital facility?

The ESO should be able to operate as a stand-alone service provider. Therefore the regulatory arrangements must allow for it to be effectively financed as an independent company separate from its parent company. This will enable the ESO function to be effectively separated from its parent company and will minimise the risks associated with any conflicts of interest. Consequently we do support the introduction of any of the mechanisms intended to provide additional security that are related to its parent company.

ESOQ12. Do you agree with our proposal relating to remove the cost sharing factor? Can you foresee any unintended consequences in doing so, and how could these be mitigated?

We agree with the proposal related to removing the cost sharing factor. The benefits that accrue to the ESO as part of the incentive scheme should, however, be earned by the ESO as part of the demonstrable out performance in relation to the measures established as part of the incentive scheme.

ESOQ13. Do you agree with our proposal to introduce a cost disallowance mechanism for demonstrably inefficient costs? What criteria should we apply in considering what constitutes 'demonstrably inefficient'?

We are unclear as to the role of a "cost disallowance" scheme as part of the RIIO-2 framework. The incentive arrangements should allow the ESO to "earn" the benefits of the incentive scheme through demonstrable out performance against the relevant measures. For example delivery of a project on time and on budget would meet the performance target and could be subject to an incentive, while delivery early at lower costs could result in enhanced benefits. Failure to out-perform would mean that enhanced benefits are unavailable.

A cost disallowance scheme may make the ESO risk averse when it comes to delivery of key elements of its business plan, or indeed result in outcomes that are less efficient when compared to an enhanced benefits incentive arrangement.

ESO innovation questions

ESOQ14. Do you agree with our proposals to retain an innovation stimulus for the ESO, but tailor aspects of this innovation stimulus to take account of the nature of the ESO business?

We do not agree with the proposals to retain an innovation stimulus for the ESO. Innovation should form part of the business as usual plans for the ESO though the relevant price control periods.

We do not support Ofgem's conclusion that removal of an innovation stimulus could limit the ESO's involvement in network innovation. In this context innovation should be required as part of the business as usual plans and form part of the culture of a fully independent ESPO. We would expect that innovation would form part of the activities identified as part of the business plan, and the funding should be incorporated in each element of the plan. Therefore innovation would be "baked in" to the ESO plans and should not be funded separately.

In addition we expect that in developing the business plans, the ESO would work with stakeholders, including other network companies to ensure that innovative approaches to solutions are clearly identified at the outset.

ESOQ15. What ESO-specific issues should we consider in the design of the ESO innovation stimulus package

We have no comments on the ESO specific issues should be considered in the design of the ESO innovation stimulus package as we do not believe that ESO a specific innovation initiative is required as part of the funding arrangements.

Appendix 3: Answers to the specific questions raised in the Consultation Document –

Gas distribution questions

We have not reviewed the Gas Distribution Price Control sector annex in great detail. However. We have specific observations on the proposed NTS Exit Capacity output (see question GDQ 42).

GDQ42. What are your views on our proposal to use final offtake capacity prices rather than T-3 offtake capacity price estimates in the calculation of incentive rewards and penalties in RIIO-GD2?

We note that Ofgem are seeking to amend the RIIO-GD1 incentive by “*replacing advance capacity price estimates with final offtake capacity prices when calculating rewards and penalties*” and “*introducing a mechanism that enables a within-period adjustment of offtake capacity baselines, to ensure ongoing alignment between baselines and peak demand forecasts*”.

We welcome these initiatives but we are concerned that that the new arrangements create new incentives for the GDNs to earn enhanced returns. Under RIIO-GD1 the GDNs have already “*earned substantial rewards*” including “*£108m in the first five years of RIIO-GD1*”. The potential approach must also take into account any revised NTS charging arrangements introduced in compliance with the TAR network Code.

In addition any baseline “adjustment” process may have implications for the availability of capacity on the GDN networks. The GDN initiatives may interact with the review of baselines (and substitution) that is included in the Gas Transport price control sector methodology review.

Appendix 4: Answers to the specific questions raised in the Consultation Document –

Gas Transmission questions

Chapter 2 - Context

GTQ1. Do you have any feedback on our proposals for simplifying the RIIO-2 gas transmission price control package, or suggestions for further simplification?

We welcome the proposals for simplifying the RIIO-2 gas transmission price control package. The gas transmission company should focus on those activities that deliver value to consumers. The outputs and incentives regime should reflect the priorities of the gas transmission company, users of the network and consumers.

GTQ2. Do you have any views on the extent to which the potential outputs discussed in this document:

- a) achieve the appropriate balance and focus on the areas that are of value to consumers and should be included as part of a RIIO-GT2 outputs package;**
- b) align with our overarching outputs framework as described in the Core Document;**
- c) we also welcome views on whether there are any alternative outputs and/ or mechanisms not identified here which we should be considering.**

The network companies should be rewarded where there is clear out performance in terms of overall customer benefits relative to the outputs that are identified. These rewards should be proportionate to the degree to which the network companies can directly influence performance.

Chapter 3 questions – Meet the needs of consumers and network users **General output questions**

GTQ3. What are your views on the overall outputs package considered for this output category?

A number of output categories could more successfully be included in the business as usual plan of the gas transmission company. This could include, for example, stakeholder engagement, customer satisfaction and the quality of demand forecasts. This would enable greater management attention on the key drivers of costs related maintenance, connection and constraint management.

There is greater scope in considering the role of the GSO and the gas network owner in delivering a low carbon and decentralised energy system. In this context the interaction between the electricity and gas networks and markets should be considered carefully in a whole systems approach.

The gas network is an important facilitator of electricity market resilience particularly in relation to provision of energy in circumstances when intermittent generation is operating. In this context, the role of the gas market, and in particular access to within day flexibility may be of paramount importance. It should be possible to recognise this in the form of the incentive regimes for the system operator and the operational capability,

particularly line pack provided by the gas network. The price control arrangements should recognise the following element:

- **The use of “spare” capacity to provide network flexibility:** Although the network may appear under-utilised in terms of gas flow the “spare” capacity is an important contributor to operational flexibility in within day storage. The contribution of such “spare” capacity should be recognised in the outputs for the gas system owner;
- **The use of within day network storage (line pack):** The role of line pack in delivering system resilience (both electricity and gas) is evident from recent events (Beast from the East). Outputs should be established for the gas system operator related to the within day use of line pack (absolute availability) and the use of line pack over a number of operational days (line pack depletion); and
- **The geographical dispersion of line pack:** The nature of the availability of line pack varies across the transmission network. It may be appropriate to provide outputs that relate to the provision of line pack in certain locations for the gas system owner and in relation to the use of such line pack to avoid gas supply interruptions that impact on the gas transmission system, the gas distribution networks, network users and consumers.

One important area for consideration in the network capability assessment is the impact of decentralised electricity generation, including gas-fired electricity generation, on the demand at DNO exit points. This should take into account the fact the customers may increasingly electricity for their heat demand, the extent to which gas is an essential back up fuel and the impact of fluctuations of decentralised electricity generation on residual gas demand.

Under certain system conditions large gas loads connected to the transmission system including gas fired power stations could be interrupted as a means of protecting DNO demand, where such demand is driven in part by small scale gas fired generation. Such an outcome is not consistent with the whole systems approach identified in the Consultation Document, and arrangements should be put in place to treat DN connected generation on the same level playing field as transmission connected generation.

GTQ4. For each potential output considered (where relevant):

a) Is it of benefit to consumers, and why?

b) How, and at what level should we set targets? (e.g. should these be relative/absolute).

c) What are your views on the design of the incentive? (e.g. reward/penalty/size of allowance).

The network companies should be rewarded where there is clear out performance in terms of overall customer benefits relative to the outputs that are identified. These rewards should be proportionate to the degree to which the network companies can directly influence performance.

GTQ5. What other outputs should we be considering, if any?

We do not have a view on any additional outputs that could be included for the gas transmission company at this stage in the price control process.

GTQ6. What are your views on the RII0-1 outputs that we propose to remove? In addition to the above questions, where relevant, please see the supplementary output specific questions below.

The gas transmission company should focus on key activities where they demonstrate that they add value to customers. The outputs regime should, therefore focus on these activities.

Supplementary output specific questions

Stakeholder Engagement Incentive

GTQ7. We welcome views from stakeholders on the above options.

We do not believe that there should be a specific incentive for stakeholder engagement as part of RIIO-ET2. Rather we believe that good customer services including stakeholder engagement should be part of business as usual and embedded in the overhead costs associated with the specific activities funded under the price control.

GTQ8. Do you think it would be possible to establish clear and appropriate KPIs and deliverables in this area?

The gas transmission company, acting as a prudent operator should establish and maintain KPIs and deliverables with regard to stakeholder engagement as part of its business as usual plans.

Satisfaction Surveys

GTQ9. We welcome views from stakeholders on the above options.

The gas transmission company should regularly survey stakeholders with regard to their performance. This should be part of a business as usual programme of engagement and should not be subject to any specific incentive arrangements.

Quality of demand forecasts

GTQ10. Does NGGT's forecasts of demand provide a service that is valued by consumers and network users? Please explain why.

NGGT acting as a reasonable and prudent operator should produce accurate and timely information that reflects the overall state of the gas transmission system. This should include signals such as gas demand forecasts in order to facilitate the functioning of the gas market. As such they are a critical element in the normal efficient operation of the GB gas market.

The provision of timely and accurate information should be included as part of the overall NGGT business as usual plans and should not be subject to a separate incentive scheme.

GTQ11. Should gas consumers pay for NGGT to produce accurate demand forecasts? What is the value for consumers from increased accuracy?

The provision of timely and accurate information should be included as part of the overall NGGT business as usual plans and should not be subject to scheme paid for directly by gas consumers.

Chapter 4 questions – Deliver an environmentally sustainable network **General output questions**

GTQ12. What are your views on the overall outputs package considered for this output category?

- a. For each potential output considered (where relevant):**
- b. Is it of benefit to consumers, and why?**
- c. How, and at what level should we set targets? (e.g. should these be relative/absolute).**
- d. What are your views on the design of the incentive? (e.g. reward/penalty/size of allowance).**

We agree that NGGT should focus on the direct environmental impact of its activities including compressor emissions, greenhouse gas venting and shrinkage. However, we believe a prudent operator should report on its business carbon footprint as part of its business as usual plans and that there is no need for a specific incentive under the price control.

GTQ13. Where we set out options, what are your views on them and please explain whether there are further options we should consider.

There is greater scope in considering the role of the GSO and the gas network owner in delivering an environmentally sustainable network. In this context the interaction between the electricity and gas networks and markets should be considered carefully.

We have some concerns about the output regarding the contribution of the NGGT in delivering low carbon energy systems. To the extent that NGGT can facilitate the transition then it is an important player in the delivery of low carbon whole system. However, NGGT should focus on the direct environmental impacts of its activities with regard to the low carbon transition. Wider incentives to deliver the transition are the responsibility of the Government and not NGGT.

GTQ14. What other outputs should we be considering, if any?

We do not believe that there are additional outputs that should be considered in relation to delivering an environmentally sustainable gas network at this stage in the price control process.

GTQ15. What are your views on the RIIO-1 outputs that we propose to remove?

We note that Ofgem are not proposing to remove any of the outputs associated with delivering environmentally sustainable gas network.

GTQ16. We welcome views on whether further regulatory mechanisms are needed to drive NGGT to be more proactive in reducing its impact on the environment and contributing to the transition to the low carbon energy system. In addition to the above questions, where relevant, please see the supplementary output specific questions below.

Further regulatory mechanisms (in addition to the outputs already identified) are not needed to drive NGGT to be more proactive in reducing its impact on the environment and contributing to the transition to the low carbon energy system.

Supplementary output specific questions

NTS Shrinkage

GTQ17. Do you think that the 'compressor fuel use' element of the shrinkage incentive should be included within NGGT's baseline Totex allowance? To what extent do you think elements of shrinkage are within the control of National Grid Gas

We agree with the proposal to include the 'compressor fuel use' element of the shrinkage incentive as part of NGGT's baseline Totex allowance. The compressor fuel usage is one of the core activities under the direct control and management of NGGT. Compressor fuel is not gas that is "lost" from the system but is directly related to the usage and efficiency of NGGT compressors. Therefore this should feature as part of its business as usual plans and treated as if it is gas "purchased" from the "system" for the purpose of operating the compressors (with an appropriate monetary value assigned to it under the procurement cost benchmark).

Including 'compressor fuel use' element of the shrinkage incentive within NGGT's baseline Totex allowance will enable shrinkage outputs to be focused on CV shrinkage and Unaccounted for Gas. We expect that NGGT would therefore develop initiatives to address specifically leakage from the system as part of this output measure.

Low carbon energy systems and decarbonisation of heat

GTQ18. Do you have any views on how NGGT's can make a contribution to the transition to a low carbon energy system and support the decarbonisation of heat?

NGGT acting as a facilitator can support the transition to a low carbon energy system and the decarbonisation of heat. Further measures are not required to ensure that NGGT performs the role that it has been assigned, namely as a system operator and gas network owner.

Opportunity to propose bespoke outputs

GTQ19. Do you think we should consider proposals from NGGT for additional outputs and incentives to support our environmental objectives?

Further proposals from NGGT for additional outputs and incentives to support wider environmental objectives are not required at this stage in the price control process. It is difficult to see the rationale for NGGT to fulfil wider environmental objectives unless those initiatives relate to activities where NGGT has direct responsibility. NGGT should focus on the direct environmental impacts of its activities and act as a facilitator of the low carbon transition as part of its business as usual plans.

Chapter 5 questions – Maintain a safe and resilient network **General output questions**

GTQ20. What are your views on the overall outputs package considered for this output category?

The overall outputs package related to the maintenance of a safe and resilient network is one the key priorities for NGGT in the price control. As noted above, the overall outputs package with respect to network resilience should take into account the use of "spare" capacity to provide network flexibility, The use of within day network storage (line pack) and the geographical dispersion of line pack.

GTQ21. For each potential output considered (where relevant):

- a. Is it of benefit to consumers, and why?**
- b. How, and at what level should we set targets? (e.g. should these be relative/absolute).**
- c. What are your views on the design of the incentive? (e.g. reward/penalty/size of allowance).**

d. Where we set out options, what are your views on them and please explain whether there are further options we should consider.

The network companies should be rewarded where there is clear out performance in terms of overall customer benefits relative to the outputs that are identified. These rewards should be proportionate to the degree to which the network companies can directly influence performance

GTQ22. What other outputs should we be considering, if any?

We do not believe that there are additional outputs that should be considered in relation to network resilience at this stage in the price control process.

GTQ23. What are your views on the RIIO-1 outputs that we propose to remove?

We note that Ofgem are not proposing to remove any of the outputs associated with safety and network resilience.

In addition to the above questions, where relevant, please see the supplementary output specific questions below.

Supplementary output specific questions

Safety

GTQ24. Do you have views on whether the proposed approach on safety is appropriate for RIIO-GT2?

We support Ofgem's proposal to retain the output measures with respect to the safety of the gas network. Safety should also be fully integrated into NGGTs business as usual plans.

Network capability

GTQ25. Do you agree with our assessment of the problems with the current arrangements, and how these problems can lead to consumer detriment?

We agree with the assessment of the problems with the current arrangements and the possibility that these could theoretically lead to consumer detriment. However we believe that there are three elements that must be taken into account in the assessment. These are:

- **The use of "spare" capacity to provide network flexibility:** Although the network may appear under-utilised in terms of gas flow the "spare" capacity is an important contributor to operational flexibility in within day storage. The contribution of such "spare" capacity should be recognised in the outputs for the gas system owner;
- **The use of within day network storage (line pack):** The role of line pack in delivering system resilience (both electricity and gas) is evident from recent events (Beast from the East). Outputs should be established for the gas system operator related to the within day use of line pack (absolute availability) and the use of line pack over a number of operational days (line pack depletion); and
- **The geographical dispersion of line pack:** The nature of the availability of line pack varies across the transmission network. It may be appropriate to provide outputs that relate to the provision of line pack in certain locations for the gas system owner and in relation to the use of such line pack to avoid gas supply

interruptions that impact on the gas transmission system, the gas distribution networks, network users and consumers.

It is possible that the current size of the network provides the level of flexibility required when assessed from the perspective of the whole energy system, including the wider electricity market. It is possible that investment in the existing gas network may provide enhanced resilience in the electricity market and provide greater flexibility in terms of the operational capability of the network.

GTQ26. Do you agree with our proposal to require NGGT to carry out an initial network capability assessment and submit the results as part of its Business Plan?

We agree that NGGT should undertake an initial network capability assessment as part of its business as usual plans. This assessment should take into account a whole system approach and consider the wider interaction with the electricity market.

One important area for consideration in the network capability assessment is the impact of decentralised electricity generation, including gas-fired electricity generation, on the demand at DNO exit points. This should also take into account the fact the customers may increasingly use electricity for their heat demand, the extent to which gas is an essential back up fuel and the impact of fluctuations in decentralised electricity generation on residual gas demand.

Under certain system conditions large gas loads connected to the transmission system including gas fired power stations could be interrupted as a means of protecting DNO demand, where such demand is driven in part by small scale gas fired generation. Such an outcome is not consistent with the whole systems approach identified in the Consultation Document, and arrangements should be put in place to treat DN connected generation on the same level playing field as transmission connected generation.

GTQ27. Do you agree that if baseline obligated entry or exit capacities are found to be at inappropriately high levels, we should consider revising them downwards in line with NGGT's proposals?

We do not agree that if baseline obligated entry or exit capacities are found to be at inappropriately high levels, we should consider revising them downwards in line with NGGT's proposals. The current level of the baselines sets a clear and transparent expectation of the size of the current gas network. Any arbitrary reduction in baselines has significant and potentially material impacts and would impact on the wider gas market and the entry and exit capacity arrangements.

Reductions in baselines would also impact on the substitution methodology and increase the risk that users will be unable to obtain sufficient capacity for their needs.

Arrangements for accessing unsold capacity

GTQ28. Do you agree with our proposal to require NGGT to review the arrangements for accessing unsold capacity?

We note Ofgem's initiative with regard to accessing unsold capacity. This issue is intrinsically linked to the implementation of the new charging regime under the TAR network code. We expect that any review of this area would take into account the new incentives created under the TAR NC to book and retain capacity, whether in the long term or the short term.

GTQ29. Do you agree with our proposed scope for the review? Are there other aspects of access that should be reviewed at the same time?

We are concerned that given the substantial and major changes happening through the implementation of the EU network codes, that there is an overload of work associated with the proposed review of unsold capacity (particularly in relation to the baseline review and capability studies indicated above). These profound and material changes will have a significant impact on the wider gas market and interact with the electricity market changes that are also taking place (particularly the electricity charging reviews).

Chapter 6 questions – Cost assessment

GTQ30. Do you agree with our intention to evolve the RIIO-GT1 approach for RIIO-GT2?

We agree with the intention to evolve the RIIO-GT1 approach for RIIO-GT2.

GTQ31. Do you have any comments on appropriate cost categories or approaches to cost assessment?

We do not have any comments on appropriate cost categories or approaches to cost assessment at this stage in the price control process.

GTQ32. Do you agree with our proposed approach to cost categorisation? Please provide an explanation to your answer.

We agree with the proposed approach to cost categorisation.

GTQ33. Do you support our view of the need for greater granularity and transparency in cost reporting to further develop our cost assessment capability?

We support the Ofgem view of the need for greater granularity and transparency in cost reporting to further develop our cost assessment capability.

GTQ34. We invite views on whether the proposed toolkit is appropriate or there are there other assessment techniques we should consider for our cost assessment toolkit in RIIO-GT2.

We do not have any views on whether the proposed toolkit is appropriate or there are there other assessment techniques we should consider for our cost assessment toolkit in RIIO-GT2 at this stage of the price control process.

Chapter 7 questions – Uncertainty mechanisms

General uncertainty mechanism questions

GTQ35. What are your views on the proposed uncertainty mechanisms and their design?

We do not have any views on the proposed uncertainty mechanisms and their design at this stage of the price control process.

GTQ36. Are there any additional mechanisms that we should be considering across the sector? If so, how should these be designed

We do not have any views on any additional mechanisms that Ofgem should be considering across the sector at this stage of the price control process.

GTQ37. What are your views on the RIIO-GT1 uncertainty mechanisms we propose to remove?

We do not have any views on the RIIO-GT1 uncertainty mechanisms Ofgem propose to remove at this stage of the price control process.

In addition to the above questions, where relevant, please see the supplementary uncertainty mechanisms questions below.

Supplementary uncertainty mechanism specific questions

Review of Agency (Xoserve) costs

GTQ38. What do you think is the most appropriate approach for funding the Gas Transporters' expenditure for Xoserve in RIIO-2? In particular, which approach do you think is in the best interest of consumers?

Since Xoserve provide clearly defined services to support the GB gas industry we would support Option 2 in relation to cost pass through. We note Ofgem's concerns regarding cost control, and we believe that Xoserve should be incentivised to efficiently and effectively manage costs. The proposed Ofgem review of funding governance and ownership provides an opportunity for a wide review of the role of Xoserve, its management and cost control.

GTQ39. If Xoserve takes on any services beyond its core Central Data Service Provider role, how should we treat the costs and risks associated with these additional services through the price control?

We do not see a role for Xoserve to take on services beyond its core Central Data Service Provider role. Xoserve should focus on the efficient and effective delivery of the essential services to support the gas industry.

Appendix 5: Answers to the specific questions raised in the Consultation Document –

Electricity Transmission questions

Chapter 3 questions – Meet the needs of consumers and network users General output questions

ETQ1. What are your views on the overall outputs package considered for this output category?

An overall outputs package should form part of the RIIO-2 price control. However we are concerned that an emphasis on the output of some of the outputs may take away attention from other outputs, and a careful balance must be struck.

In the context of outputs we note that there appear to be several outputs that are key elements of performance by the TOs. These include successful delivery of large capital investment projects and energy not supplied. These should form part of a core package of deliverables alongside bespoke elements proposed by the TO whether they relate to core activities.

Some of the outputs relate to successful administration including stakeholder engagement surveys, environmental considerations embedded into business plans and additional contribution to low carbon transition. These are essentially secondary elements which should not be such a high priority as the core elements.

We also note that there are also elements of the outputs that could be considered part of business as usual including compliance with environmental regulations such as sulphur hexafluoride and other IIG leakage and managing visual amenity. These elements should be included in the business as usual plans and not be subject to specific outputs.

ETQ2. For each potential output considered (where relevant):

a) Is it of benefit to consumers, and why?

b) How, and at what level should we set targets? (e.g. should these be relative/absolute)

c) What are your views on the design of the incentive? (e.g. reward/penalty/size of allowance)

d) Where we set out options, what are your views on them and please explain whether there are further options we should consider?

The network companies should be rewarded where there is clear out performance in terms of overall customer benefits relative to the outputs that are identified. These rewards should be proportionate to the degree to which the network companies can directly influence performance.

ETQ3. What other outputs should we be considering, if any?

For RIIO-ET2 the principal focus of the network companies should be on delivery of the core outputs as part of the business plan. We do not support the creation of additional output measures as part of RIIO-ET2.

ETQ4. What are your views on the RIIO-ET1 outputs that we propose to remove? In addition to the above questions, where relevant, please see the supplementary output specific questions below.

For RIIO-ET2 the principal focus of the network companies should be on delivery of the core outputs as part of the business plan. The secondary elements should be included as part of the business as usual in the relevant plans.

Supplementary output specific questions

Stakeholder Satisfaction Output: Stakeholder Engagement Incentive

ETQ5. We welcome views on whether a specific incentive for stakeholder engagement is appropriate in RIIO-ET2, and if so, whether this should be reputational or financial.

We do not believe that there should be a specific incentive for stakeholder engagement as part of RIIO-ET2. Rather we believe that good customer services including stakeholder engagement should be part of business as usual and embedded in the overhead costs associated with the specific activities funded under the price control.

ETQ6. Do you think individual components of the SSO should be combined into a single incentive mechanism in RIIO-ET2, should the SEI and components of the SSO be retained?

It would be sensible to consolidate the stakeholder engagement measures into a single measure if it is retained. However, it is our preference that there is no separate incentive for stakeholder engagement subject to such engagement form part of business as usual plans.

ETQ7. We invite views on types of Business Plan commitments that would be appropriate for stakeholder engagement.

The nature of stakeholder engagements should be measured against the specific activities undertaken by the network companies. For example, close liaison with stakeholders around the technical requirements for connection to the relevant network would be expected. This could take the form of an ongoing programme of seminars, working groups, technical newsletters and specific one to one engagement. Such engagement plans should form part of the funding requirement for each activity as proposed by the network companies in consultation with stakeholders.

ETQ8. We welcome views on the potential approaches to setting a financial incentive for the SSO in RIIO-ET2, if retained. Are there any other considerations we should take into account if we move to a fixed reward pot that network companies compete for?

We do not support the maintenance of a financial incentive for the SSO in RIIO-ET2.

Stakeholder Satisfaction Output: Satisfaction Survey, KPIs, and External Assurance components

ETQ9. Do you have any views on whether we should retain a TO User Survey, targeted at a number of key areas as identified in this document? Are there any alternative mechanisms to address potential issues in these areas we should be considering?

The TOs should regularly survey their stakeholders with regard to performance. This should be part of a business as usual programme of engagement and should not be subject to any specific incentive arrangements.

ETQ10. Are there any other areas, beyond those identified in this consultation document, which we should consider targeting through a potential survey?

We do not have any views on additional areas beyond those identified in this consultation document, which we should consider targeting through a potential survey at this stage in the consultation process.

ETQ11. Do you have any views on our proposal to retain one question on overall satisfaction from which the scores will be collated?

This question relates to the overall design of an efficient survey which seeks to provide an benchmark level against which performance can be measured. A single question may be subject to the bias of the responder and may not provide a reliable answer to the question that is being posed.

ETQ12. Do you agree that we should use RIIO-ET1 performance as a starting point for setting a RIIO-ET2 baseline? What alternative approach(es) should we consider?

We agree that is the stakeholder incentives are retained that the RIIO-ET1 performance should be a starting point for setting the RIIO-ET2 baseline.

ETQ13. Do you agree that the User Groups could provide guidance on the stakeholders that should be included in the survey sample? Are there any specific stakeholders that you think must be surveyed to improve the validity of the scores?

We agree that the User Groups could provide guidance on the stakeholders that should be included in the survey sample. We do not have any views on specific stakeholders that must be surveyed to improve the validity of the scores. However, the sample must be representative of the users of the activities provided by the network company.

ETQ14. Do you agree with our proposals to remove the financial incentive associated with the KPI and EA components? Should the EA component be retained as a minimum requirement/ licence obligation?

We agree with the proposal to remove the financial incentive associated with the KPI and EA components. A prudent operator should ensure that a customer engagement process is subject to appropriate external assurance, and provide information that enables regulatory oversight of this matter.

Timely Connections Output

ETQ15. Do you have any views on whether we should retain the RIIO-ET1 Timely Connections Output (which applies to the connection offer stage) for RIIO-ET2, including the penalty rate, and extend it to NGET?

The RIIO-ET1 Timely Connections Output (which applies to the connection offer stage) should not apply in RIIO-ET2.

The electricity transmission company has a licence obligation to provide connection offers within a specific timescale. In addition, a prudent operator would already provide relevant information on the connections process, the progress of connection offers and input to the final connection agreement. Consequently we do not believe that the transmission companies should have additional incentives (in the form of penalties) for

actually complying with its licence obligations. Failure to perform in this area should be subject to normal licence compliance arrangements.

ETQ16. Do you have any views on options for capturing the quality of the overall connections process through our stakeholder engagement proposals, for example through the use of a survey?

We expect that the quality of the overall connections process should be monitored as part of the business as usual for the transmission companies. The transmission companies should therefore include proposals from monitoring performance as part of their business plans.

ETQ17. Are there any alternative options for capturing the quality of the overall connection process, not identified in this consultation document, which we should be considering?

Stakeholders have a key role to play in assessing the performance of the transmission companies in relation to the connections process.

The transmission companies act as monopoly providers and there may be concerns from stakeholders from providing information in relation to sensitive negotiations regarding connection offers. This must be recognised in the process associated with monitoring performance.

ETQ18. How do you think we can ensure that transmission operators are not rewarded and/or penalised for actions actually undertaken by the System Operator?

The question relates to the relationship between the transmission owners and the GB ESO. This is formalised in the System operator and Transmission Owner Code (STC) and this code should be the basis for managing and resolving any disputes between the ESO and the transmission companies. If necessary sanctions associated with failure to perform could be established under the STC for example, in relation to the connections process.

The relationship between the ESO and its associated transmission company should be subject to particular regulatory oversight given the potential for conflicts of interest.

Energy Not Supplied

ETQ19. Do you have any views on whether we should retain the ENS incentive, and whether we should retain it as a positive reward mechanism, or move towards a penalty-only scheme? What impact could the move to a penalty-only mechanism have on TO decision-making and behaviours? Please evidence.

We support the retention of an incentive in relation to energy not supplied. The reliability of the transmission system is a core activity for the transmission companies and we welcome the high levels of network availability demonstrated across the RII0-ET1 period. The incentive reflects the wider consumer benefits associated with the maintenance of a reliable system. In addition, the incentive mechanism allows the transmission companies to invest in innovative solutions as part of business as usual and this should be reflected in their business plans.

ETQ20. Do you have any views on how Ofgem should take into account issues other than past performance when determining baseline targets? For example, processes adopted as BAU, increased TO experience and expertise on fault

mitigation and management, future modernisation projects, etc. What adjustment mechanisms are appropriate?

The transmission companies should include initiatives to maintain and improve the reliability of their networks as part of their business as usual plans. This should include regular performance reporting. Performance that exceeds business as usual plans should be subject to an incentive mechanism, taking into account the already high levels of reliability. Consequently we do not see a role for adjustment mechanism as part of the price control process.

ETQ21. Is the introduction of an improvement factor appropriate within the context of the electricity transmission system? What other mechanisms are appropriate?

We do not see the need for an “improvement factor” as part of the price controls. Rather we would expect that the transmission companies should indicate the potential for “improvement” as part of the business as usual plans.

ETQ22. We welcome views on additional considerations we should take into account when setting baseline targets?

The transmission companies already operate networks with high levels of reliability, which should be maintained. The process of decarbonisation and decentralisation has implications for these electricity networks and should be taken into account in the assessment of reliability. This should reflect the geographic dispersion of generation, the changes in patterns of demand, the intermittent nature of the generation fleet and the reliability of certain transmission lines associated with certain power stations at times of critical demand peaks.

ETQ23. Do you agree with our proposals to base the ENS incentive rate in RIIO-ET2 on an updated, agreed VoLL?

We agree that the ENS incentive rate in RIIO-ET2 should be based on an updated and agreed VoLL. However an update to the level of VoLL has implications for the wider electricity market and in particular the VoLL used in the electricity balancing arrangements. It would be appropriate that these arrangements are considered in any updated analysis of VoLL.

ETQ24. Do you agree with our proposals to retain the financial collar for the ENS incentive in RIIO-ET2?

WE agree with the proposal to retain the financial collar for the ENS incentive in RIIO-ET2.

A financial collar will limit the downside risk associated with a failure to maintain the required performance levels associated with system reliability. Performance below the financial collar may reflect underlying concerns about wider network reliability and should be subject to appropriate levels of regulatory oversight (licence compliance).

ETQ25. We welcome views on approaches to estimating embedded generation at GSP points.

The consultation document focus on than assessment of embedded generation at GSP points. This approach misses the effect that fluctuations in demand including demand side response and behind the meter generation has a similar effect to traditional embedded generation as GSPs.

The transmission companies and the ESO need much greater information on generation and load connected to distribution networks and on the potential fluctuations in demand at GSPs, including the potential for GSPs to export onto the transmission system. This is not just a question in terms of estimating outputs, but also impacts on the potential for network investment. It could be appropriate, for example, to require DNOs to secure TEC on behalf of generation exports from the distribution networks. This capacity could be driven by increased generation outputs or reduced demand.

ETQ26. What measures need to be in place to facilitate the collection of data on embedded generations and other real time information? How do you propose to approximate embedded generation data?

The key actors in provision of information at GSPs are the transmission companies, the ESO and the distribution companies. Appropriate incentives are required to ensure that appropriate levels of information are shared between the relevant actors.

The transmission companies should actively monitor the flows from the relevant distribution networks (imports and exports). This information should be open and transparent and form one of the inputs to the ENS incentive.

ETQ27. We invite views on changing the metrics used to measure reliability on the transmission system from MWh lost to CI/CML? What measures and processes (e.g. data sharing frameworks) need to be in place to facilitate the collection of CI/CML data?

The transmission companies should report on both MWh lost and customers interrupted and customer minutes lost as part of the ENS measure. However with regard to the transmission companies the measures should be in relation to those connected to the transmission system including DNOs at GSPs. A composite of these variables should feed into the incentive mechanism that reflects the relative importance of each variable.

ETQ28. Do you have any views on whether all loss of supply events should be incentivised? Do you have any views on amending the scope of the definition of events excluded as 'loss of supply events' and/or 'exceptional events'?

Historic information on the different classes of events should be provided to determine the basis on which performance is measured in the incentive scheme. It would seem appropriate to exclude genuinely "exceptional" events from the scheme such as threat of war. However, it may be appropriate to include events such as severe weather in the scheme to ensure that there are appropriate incentives to maintain the network in such circumstances (for example during the so called "Beast from the east" on 1 March 2018).

Chapter 4 questions – Deliver an environmentally sustainable network
General output questions

ETQ29. What are your views on the overall outputs package considered for this output category?

We expect that the objective to deliver an environmentally sustainable network should form part of business as usual for the transmission companies as part of the price control arrangements.

We see a specific role for incentives on activities that have a direct impact on the environment, particularly in relations to sulphur hexafluoride and other IIG leakage.

ETQ30. For each potential output considered (where relevant):

a) Is it of benefit to consumers, and why?

b) How, and at what level should we set targets? (e.g. should these be relative/absolute)

c) What are your views on the design of the incentive? (e.g. reward/penalty/size of allowance)

d) Where we set out options, what are your views on them and please explain whether there are further options we should consider?

The incentive framework should concentrate on the direct environmental impact of the transmission company activities. In this context one of the main areas for consideration should be sulphur hexafluoride and other IIG leakage.

Wider environmental considerations should form part of the general corporate responsibility of the companies. We would expect a prudent operator to provide information on environmental impacts as part of the business plans, and to provide an appropriated level of reporting. Visual amenity should be assessed as part of the business as usual plans.

While the transmission companies have a key role to play in the transition to a low carbon system we do not believe that there should be a specific output measure. The delivery of a low carbon outcomes should be the responsibility of the government through its various initiatives such as the carbon floor price and CFDs.

ETQ31. What other outputs should we be considering, if any?

We do not believe that there are any other outputs that should be considered.

ETQ32. What are your views on the RIIO-ET1 outputs that we propose to remove? In addition to the above questions, where relevant, please see the supplementary output specific questions below.

We expect that there should be fewer outputs in this area and that environmental considerations should be a key component of the business as usual plans.

Supplementary output specific questions

Environmental framework - Business Plans and annual monitoring

ETQ33. Do you have any views on the extent to which company activities relating to environmental impacts should be embedded in Business Plans?

The transmission companies should identify the environmental impact of their activities as part of their business plans. Where there are options that have differing environmental impacts, the companies should provide a justification of the way forward (preferred option) that includes an assessment of the wider welfare benefits of the various options, and include on this the social cost of carbon emissions.

ETQ34. We invite views on whether the proposed environmental impact categories are appropriate areas to focus on. Are there any areas that should be excluded and/ or other areas that should be covered? We also invite views on the potential indicators and/ or metrics that are appropriate for each environmental impact category.

We agree that the proposed environmental impact categories are appropriate areas to focus on.

ETQ35. We welcome views on the option of an annual reporting framework to increase transparency of the transmission networks' impact on the environment.

The production of an annual report on the transmission networks' impact on the environment should form part of the general corporate responsibility. Consequently we do not see the need to include an annual reporting framework.

The specific environmental initiatives included in the business plans will require regular transparent reporting to ensure an appropriate level of regulatory oversight.

Potential for bespoke ODIs around the low carbon transition

ETQ36. We welcome views on whether we should introduce an option for the TOs to develop bespoke ODIs with stakeholders for delivering an additional contribution to the low carbon transition.

We acknowledge that the transmission companies have a key role to play in the low carbon transition. However, the companies do not have a specific responsibility for contributing to this transition. The Government is a key actor in delivering the transition through policy initiatives such as the carbon price floor and contracts for differences for low carbon technologies. Therefore, it is not appropriate to introduce an option for the TOs to develop bespoke ODIs with stakeholders for delivering an additional contribution to the low carbon transition.

ETQ37. We invite views on the kind of activities, not captured elsewhere, that could be captured through such ODIs.

We do not support the introduction of an option for the TOs to develop bespoke ODIs with stakeholders for delivering an additional contribution to the low carbon transition.

ETQ38. We invite views on how such an ODI might operate, and any other factors we should take into account in considering bespoke ODI for the low carbon transition.

We do not support the introduction of an option for the TOs to develop bespoke ODIs with stakeholders for delivering an additional contribution to the low carbon transition.

SF6 and other insulation and interruption gases (IIG) leakage

ETQ39. We welcome views on whether we should retain a financial reward and penalty incentive for the leakage of SF6 in RIIO-ET2, or move to a penalty only or reputational incentive.

We agree that an incentive arrangement should remain in place for in RIIO-ET2 in relation to the leakage of SF6.

ETQ40. We welcome views on the potential impact of a move away from a financial incentive (or move to penalty-only) on TO behaviours.

A financial incentive arrangement has a strong influence in corporate behaviour and directly reflects the potential impact (harm) of SF6 assets

ETQ41. We invite views on whether leakage from other IIGs should also be captured in the incentive measure.

Given the impact on emissions, the key focus for the incentive should be Sf6 leakage. However, a subsidiary incentive could focus on other IIGs if such leakage has a material impact.

ETQ42. We welcome views on whether some leakage events should continue to be excluded from the incentive.

It seems sensible to exclude leakage events related to exception circumstances from the incentive arrangements.

Electricity losses from the transmission network

ETQ43. Do you have any views on the proposed approach for integrating any losses reporting requirements into the proposed Business Plan and annual public reporting framework?

Consideration of losses should be fully embedded in the transmission companies business plans. The transmission companies should identify the impact of various different options on losses in the business plan preparation and highlight the alternative strategies for mitigating the impact.

ETQ44. Do you have any views on the introduction of a target or measure for improving metering at and the energy efficiency of substations? How could this work in practice?

We do not have a view on the introduction of a target or measure for improving metering at and the energy efficiency of substations. However, any incentives in this area should be proportionate in relation to the extent that increased monitoring costs results in initiatives that reduce the cost of the overall level of losses at that location.

Visual amenity impacts of transmission infrastructure

ETQ45. We welcome views on incentivising the TOs' engagement with stakeholders on the development of new transmission projects through our stakeholder engagement proposals, for example through the use of a survey.

Consideration of visual amenity including engagements with stakeholders should be fully embedded in the transmission companies plans for new transmission projects. The transmission companies should identify the impact of various different options on visual amenity in the business plan preparation and highlight the cost of alternative strategies for mitigating the potential impact.

ETQ46. Do you have views on the retaining the existing scheme to mitigate the visual impact of pre-existing transmission infrastructure in designated areas? Do you agree that any decision to implement new funding arrangements should be subject to updated analysis around willingness to pay?

We do not believe that the new funding arrangements for mitigation of visual amenity for existing transmission assets in designated areas should be retained. If there are wider societal benefits by addressing the visual amenity aspects of transmission assets then this should be addressed by funding that is outside the price control arrangements, for example through Government support. This would ensure that the electricity bill payer does not pay directly for these wider societal benefits under the price control.

ETQ47. Do you agree with our proposals to modify the implementation process by which funding requests for mitigation projects are submitted and approved?

If funding of mitigation projects is allowed under the price control, then the proposals to modify the implementation process seem sensible. However this should include an assessment of wider societal benefits and be subject to a consultation process rather than a simple survey.

ETQ48. We welcome stakeholders' views on any other considerations they think are relevant to policy development for visual amenity issues in RIIO-ET2.

The wider societal benefits that could arise by addressing the visual amenity aspects of transmission assets should be addressed by funding that is outside the price control arrangements, for example through Government grants. This would ensure that the electricity bill payer does not pay directly for these wider societal benefits under the price control.

Chapter 5 questions – Maintain a safe and resilient network

General output questions

ETQ49. What are your views on the overall outputs package considered for this output category?

The outputs focused on the maintenance of a safe and resilient network should be a key priority for the electricity transmission companies and the price control. Network maintenance and network resilience are core activities for these companies and require careful management in the transition to a decarbonised and decentralised energy system.

ETQ50. For each potential output considered (where relevant):

- a) Is it of benefit to consumers, and why?**
- b) How, and at what level should we set targets? (e.g. should these be relative/absolute)**
- c) What are your views on the design of the incentive? (e.g. reward/penalty/size of allowance)**
- d) Where we set out options, what are your views on them and please explain whether there are further options we should consider?**

We have no comments on question ETQ50 at this stage.

ETQ51. What other outputs should we be considering, if any?

We have no comments on question ETQ50 at this stage.

ETQ52. What are your views on the RIIO-ET1 outputs that we propose to remove? In addition to the above questions, where relevant, please see the supplementary output specific questions below.

We note that Ofgem are not proposing to remove any RIIO-ET1 with respect to maintenance of a safe and reliable network.

Supplementary output specific questions

Network Access Policy (NAP)

ETQ53. Do you agree with our proposed approach to safety?

We agree with the proposed approach to safety set out in the Consultation Document.

ETQ54. Do you agree with our proposal to retain the NAP as a licence obligation?

The coordination of outages and the effective management of maintenance is a core activity for the ESO, the transmission companies and wider stakeholders. We support the requirement to have a network access policy in place between the TSO, the ESO and all relevant stakeholders with respect to outage planning.

We believe that this output could be strengthened with respect to the effective management of outages. Ofgem currently manages failures to comply with the NAP as a breach of licence. There is scope, however, to consider the wider effect of outages on the electricity market and ensure that there is a relevant measure of the costs of outages on the market. This could include for example, an incentive based on the transmission owners "buying back" elements of the network (at market value) to undertake essential element so maintenance where this cannot be achieved through normal coordinated outage planning. This measure could also apply to outages that overrun, and indeed could provide an incentive to complete outages earlier. We see a need to introduce a financial discipline on network owners and to introduce effective measures that compensate users for the unavailability of the transmission system. It would also focus the management of outages on periods when the costs to the wider electricity market can be minimised, for the benefit of customers.

ETQ55. Do you have any views on the potential risks and benefits of introducing a single, consolidated NAP, and of expanding the NAP to cover interactions with third parties?

A single consolidated NAP for GB seems a welcome development, where this results in a consistent approach to outage planning across the ownership boundaries of the network companies.

However, it should be recognised that outage planning which relates to the activities of each transmission company must be effective. The effective management of outages by each transmission company in relation to their in the transmission areas should remain a key priority as part of the price control.

It is essential that the NAP should expand to cover interactions with other parties.

ETQ56. We welcome views on these proposals, and on any potential interactions and/ or duplications between these proposals, the NAP and the STC.

The management of outages is currently coordinated through the STC and through provisions in the Grid Code with respect to data submissions. These arrangements could be improved by greater involvement of wider stakeholders in the effective management of outages. This would ensure, for example, that the impact of significant transmission outages on wider stakeholders could be minimised (while respecting concerns about the possibility of market power that may occur as a result of greater information on transmission outages).

The outcomes of the outage programme in terms of reduced risk of failure (preventative maintenance) or reduced constraint costs should be recognised as part of the price control. This could provide an incentive on the transmission owners to focus on activities that have a wider customer benefit.

Successful delivery of large capital investment projects

ETQ57. Do you agree with our proposed approach for ensuring TOs do not benefit financially from delays in delivering large capital investment projects?

We agree with the proposed approach for ensuring TOs do not benefit financially from delays in delivering large capital investment projects.

We support the introduced a milestone approach towards the recovery of allowances by the transmission companies with respect to large capital projects. The milestone approach better reflects the decision making process associated with projects and the delivery of key elements of the project. In addition, it better reflects the profiling of capital expenditure and could introduce greater financial discipline on the transmission companies (and their contractors). For example release of funds in capital projects is typically associated with the delivery of key items of plant or the completion of key build components.

In the context of milestones, consideration may need to be given to the late delivery and whether there are any penalties or sanctions for failure to meet milestones. This may increase the complexity of the process but may better reflects the risks onto the transmission companies. However, the design of mitigation measures need to be considered against the potential impact of increased risk on the cost of capital.

ETQ59. Are there any alternatives which we should also consider?

We do not have any views on potential alternatives to the milestone approach at this stage.

ETQ60. We invite views on the circumstances we should consider options for minimising consumer detriment and/ or sharing consumer detriment with consumers.

In circumstances where companies have clearly not acted efficiently or not acted in the interest of consumers, we would expect that Ofgem should undertake enforcement action under the terms of the relevant licence.

ETQ61. We are seeking views on these two options, including ways in which we could measure and reflect consumer detriment.

It is difficult to determine the effects of unsuccessful, delayed or "poor quality" delivery of major projects. However, the transmission companies should produce clear transparent plans outlining the work involved in major projects and should provide regular reports on progress (linked to the milestone approach).

Project progress could be subject to external scrutiny by some form of assessment panel (or Ofgem appointed quality assurance agent) to determine whether the transmission companies are delivering the required projects to predetermined criteria or defined standards. This could be used as the basis for determining the nature of unsuccessful, delayed or "poor quality" project delivery. Sanctions including delays to allowances or fixed percentage reductions in project allowances could be introduced as part of the process. Equally incentive rewards could be provided if project delivery results in enhanced customer benefits.

ETQ62. Are there any alternatives not identified here which you think we should be considering?

The milestone approach could be linked to appropriate mitigation measures including delays to financial allowances in the event that key elements of major projects were delivered late.

Chapter 6 questions – Cost assessment

ETQ63. Do you agree with our intention to evolve the RIIO-ET1 approach for RIIO-ET2?

We agree with the intention to evolve the RIIO-ET1 approach for RIIO-ET2.

ETQ64. Do you have any comments on appropriate cost categories, cost drivers or approaches to cost assessment?

We do not have any comments on appropriate cost categories, cost drivers or approaches to cost assessment.

ETQ65. We invite views on the appropriateness of our proposed cost categories for RIIO-ET2.

We the proposed cost categories for RIIO-ET2 and the intention to seek additional granularity on some cost categories as part of the process of assessing costs. We note, that development of the cost assessment methodology should result in robust outcomes that do not create an additional regulatory burden, and cost, for the transmission companies.

ETQ66. We invite views on the principles of a good cost driver and our approach to identifying suitable RIIO-ET2 cost drivers is appropriate.

We do not have any views on the principles of a good cost driver and our approach to identifying suitable RIIO-ET2 cost drivers is appropriate at this stage of the price control process.

The proposed changes to the charging regime, together with the impact of distributed technologies has the potential to impact significantly on the cost drivers for the transmission companies. It is important that the key drivers are identified as part of the price control process so that they can be effectively included in the business plans.

ETQ67. We welcome any early views on how we can combine the analysis in order to ensure ex ante allowances reflect efficient costs.

We do not have any specific views on how we can combine the analysis in order to ensure ex ante allowances reflect efficient costs. However, the cost assessment analysis should open and transparent for all stakeholders. In addition it should not introduce a significant regulatory burden (and cost) for the transmission companies.

Chapter 7 questions – Uncertainty mechanisms

General uncertainty mechanism questions

ETQ68. We would welcome views on the design and suitability of existing uncertainty mechanisms for RIIO-ET2, and whether any of these should be removed.

We agree that many of the RIIO-ET1 uncertainties would appear to be relevant for the RIIO-ET2 period. Therefore there is a case that the uncertainty mechanisms should

continue to operate. However, these mechanisms should be coherent and consistent across all the transmission companies.

ETQ69. Are there any additional mechanisms that we should consider across the sector and if so, how should these be designed?

We do not have any views on additional mechanisms that we should consider across the sector at this stage of the consultation.

ETQ70. We would welcome views from respondents on the continuing relevance of these mechanisms and any changes to the way that they operate if they are to continue.

The existing uncertainty mechanisms used on RIIO-ET1 seem a sensible basis for consideration on RIIO-ET2. However, we note that the elements related to physical security and cyber security could form part of the business as usual plans for the transmission companies.