Annex: Sector specific questions

Northern Powergrid's RIIO-T2 and GD2 methodology response

March 2019

Contents

1. Electricity system operator questions

ESO roles and principles

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

1. Yes. The framework of roles and principles has only been recently established and should be evaluated for longer before any major changes are made.
2. Looking more widely at the overall framework for the ESO, of a lightly capitalised entity facing cost pass through plus a margin, and a +/-£30m adjustment, we think this will secure only one thing; direct control by Ofgem of the levels of profit earned by the ESO, with the option to tune it up or down depending on how Ofgem thinks the ESO has done.
3. We doubt that this will secure good outcomes for consumers over the longer term.

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 RIIO-2? Do you believe that any of these functions (or any other functions) should be opened up to competition, either now or in future?

4. Yes, we agree. Given the ESO's technical expertise in the transmission system, it makes sense for it to conduct many of these roles. The ESO is also going through the closing stages of a process of separation and it makes sense to retain the existing roles for longer to allow for the new arrangements to be evaluated.
5. However, Ofgem needs to keep the arrangements under review, given that expenditure by the ESO and National Grid's TNO are regulated in different ways. We agree that Ofgem should "aim to resolve any potential conflicts of this nature through the new price control."[1]

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

6. Yes, the ESO is best-placed to run early and late competitions in respect of transmission system level issues. It carries the necessary technical expertise in respect of those systems.
7. However, Ofgem must be mindful that the full RIIO model was not applied to the ESO or National Grid's transmission operations at RIIO-1. This created unbalanced incentives. Although separation will help reduce some risks, there will still be a real conflict of interest anywhere that the ESO's choices could impose additional unfunded costs on NGET, or relieve it of the need to undertake expenditure. The ET2 and ESO framework should aim to minimise these genuine conflicts, by aligning incentives.

[1] The consultation, ESO annex, page 9, paragraph 2.5

8. Turning to electricity distribution, DNOs are best placed to run early and late competitions in respect of distribution system level issues. They carry the necessary technical expertise in respect of those systems. Equalised incentives were put in place across most categories of cost at DPCR5, and extended further at ED1, in the form of a single sharing factor and capitalisation rate being applied to all totex costs. This is also applied to the costs that flow from early, native, competition. This means that DNOs have no incentive to favour internal, investment based, solutions over external asset light (or even external asset heavy) solutions. This regulates away potential conflicts of interest that could otherwise arise in the role, even in respect of early competitions, provided that payments to the competition winner are funded by the DNO from its totex allowances.

Price control process

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.

9. We are not certain. We are not sufficiently familiar with the ESO's business on a standalone basis to comment on whether a price control process based on business plan submission every two years is appropriate. It may be, for a capital light and standalone entity facing material change in its activities in a short timeframe and with limited ability to control those changes. However, it also has the potential to weaken incentives to reduce or contain costs.[2]

10. We can however say that it would not be an appropriate framework for the DSO role, either while it is emerging or in the longer term. Ofgem should instead keep the DSO role tightly integrated with the main price control arrangements, in order that it can ensure equalised incentives between different operating approaches.

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?

11. We agree with these proposals in narrow terms. But, in tandem with cost-pass-through plus margin based regulation, they will create many incentives to incur additional costs that are not in the interests of consumers.

12. The ESO should of course undertake effective stakeholder engagement to understand the requirements of interested parties in discharging its roles and responsibilities. However, the interests of these stakeholders may not be aligned with those of energy consumers. Ofgem needs to consider carefully the weight it can place on the outcome of that engagement. The consultation states that it is "crucial that the business plans produced by the ESO reflect industry and stakeholder priorities". But the overall framework needs to reflect the interests of consumers.

[2] We note Ofgem also appears to be largely switching off ex ante cost incentives, which we comment on in our response to ESOQ12 below

13. The ESO is also undertaking stakeholder engagement on how the regulatory framework might work in future. While it should be free to undertake this research, and submit the results to Ofgem as part of its evidence case, Ofgem should continue to undertake its own impartial consultation and consideration on the appropriate regulatory framework.

ESO output and incentives

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

14. We have no specific views on the current approach to ESO output performance incentives, except that Ofgem should continue to evaluate how well it is working.

15. As a general point, however, where Ofgem can objectively measure and verify performance on outcomes that matter to consumers, and estimate the consumer value from changes in outcomes, it should set mechanistic incentives with evidence based targets.

16. The option being proposed for the ESO would be inappropriate for regulation of DSO. For DSOs Ofgem should instead apply option 1 (a whole DSO system cost incentive) combined with outcome incentives on those areas of performance that matter directly to consumers.

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?

17. Our answer depends on other decisions being taken by Ofgem following the Consultation. Whether or not it makes sense to retain this approach to the performance incentive scheme at RIIO-2 will interact with other changes being proposed to the arrangements (such as RAV vs margin based regulation) and so it is not entirely clear whether or not Ofgem should continue this approach in the longer term.

18. In the context of RAV based regulation, incentive schemes should offer broadly symmetrical performance rewards.

ESO cost assessment

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?

19. We agree with most but not all aspects of Ofgem's proposals for cost assessment in the specific context of the ESO. However, Ofgem also proposes to replace the results of its cost assessment with the actual costs of the company, plus a margin, fundamentally undermining one of the main reasons for undertaking cost assessment: to set allowances.

20. The consultation notes that the ESO is a relatively idiosyncratic organisation, and that there is a lack of direct comparators that Ofgem can use to inform its view of an efficient level of costs and that this precludes a top down totex approach to cost assessment. We agree this is the case.

21. This then leaves only more granular forms of cost assessment.

    a. Activity base costing is appropriate. This should clearly distinguish business support functions from functions that directly deliver the activities of the ESO. A capital and operating cost split will only be relevant insofar as this is used in the price control.

    b. The T1 approach of an expert consultancy review of the businesses' cost base and proposals seems the only viable option, combined with historical or external benchmarks where possible.

    c. Third party audit might enhance these expert consultancy reviews; it will depend on the terms of reference of the auditors.

    d. We agree that a principles based split will be difficult to implement due to overlaps in the principles that specific costs support.

    e. Assessment of the ESO's cost and performance must be mindful of interactions across the whole system, and this can only be achieved by looking at activity costs in the context of the services the ESO procures on behalf of the system.

22. Ofgem cannot place reliance on "stakeholder views and evidence" to "form a key part of our cost assessment of the ESO".[3] Stakeholders that lack Ofgem's information gathering powers face a significantly worse informational disadvantage than Ofgem. They will also lack the resource to undertake this expert task. And lastly individual stakeholder incentives and preferences may not be well aligned with those of stakeholders and consumers in general.

23. The informational monopoly held by the ESO makes it essential to give it incentives to propose an efficient cost base, and then contain its costs on an ongoing basis. The proposals made in the Consultation instead appear designed to provide a weak set of incentives on the ESO to contain its costs.

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?

24. We provide our views on cost assessment activities as part of our response to ESOQ8 above

[3] The consultation, ESO annex,

ESO finance

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?

25. No, we don't. These give altogether the wrong set of incentives. A time of uncertainty over the appropriate level of costs for the ESO is actually the time when consumers will benefit most from strong incentives for it to contain the costs incurred. A move to a two yearly price control reset may be an appropriate response to a higher than previous degree of uncertainty. But a move to cost-pass through will virtually remove discipline on its cost base.

26. Ofgem criticises a RAV base approach in the context of an asset light company because "such a high WACC could skew the incentives of the ESO, encouraging them to prioritise increasing their RAV through capital expenditure, potentially at the expense of more efficient operational expenditure".[4]

27. This fundamentally fails to assess the model on its merits, because:

    a. The higher WACC would only be necessary insofar as the business carried political, regulatory or operating risks that led it to be high risk. Because the investments would be high risk, the operator would have no incentive to over-invest if the WACC reflected those risks.

    b. Even with a higher WACC, the RIIO-1 framework applies a single capitalisation rate and sharing factor to all costs. There is therefore no incentive to favour capital versus operating costs.

28. The same critique actually applies to any method of remuneration with a margin. The margin should not exceed a level that covers the risks entailed in running the business, including a reasonable WACC on any regulatory capital that is tied up in the business. If the margin is set at levels above the risk entailed by making investments in the business, the ESO will have an incentive to adopt more expensive solutions in order to become more profitable.

29. As a matter of principle a margin based approach with cost pass through should actually allow the same level of annual profit as a RAV plus WACC based approach with pass through, where the regulatory capital tied up in both businesses is equivalent.

[4] The consultation, ESO annex, pages40-41, paragraph 9.1, 1st bullet point

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?

30. Yes, we see fundamental risks. A move to cost pass through for a whole regulated entity will remove discipline on costs, costs will rise, and consumers will pay more than they need to. The proposal to apply cost pass through to the entire cost base instead reflects the tendency in the Consultation to remove the incentives that have served consumers so well since privatisation.

31. Any margin applied to cost pass through costs should reflect the risks incurred in providing the service. On a cost pass through approach, these risks would be limited to regulatory risks associated with Ofgem's assessment of managerial and operational decisions taken in the running of the limited number of remaining incentive schemes, and any risk associated with enforcement action by Ofgem.

32. If the ESO is exposed to some genuine operational or counterparty risks in providing a service, a higher margin would of course be justified. Whether or not it is depends entirely on how the regulatory arrangements are specified and the exposure the ESO carries in relation to its activities.

33. We have also highlighted that one of the advantages of maintaining system operation and asset ownership within the same organisation is that the entire organisation is asset heavy, and can be exposed financially to the costs of the its performance, including in system operation. The legal separation of the ESO from NGET will remove this advantage of retaining the ESO as part of National Grid. The suggested parent company guarantee from National Grid would help to restore this link and, if provided, would give another reason to allow some margin on the ESO's costs.

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?

34. No, we don't. These proposals amount to giving up on incentives for the ESO to keep the costs it imposes on energy consumers low.

35. The consequence of a complete lack of discipline on costs within the price control period cannot be mitigated within the proposals. Some genuine incentives on the ESO's costs would be necessary. Ofgem should put these in place, relying on the "pressure release valve" of a two year business planning cycle for the ESO, as a means of "providing flexibility and allowing the roles and responsibilities (and associated costs) of the ESO to be 'reset'"[5].

36. If Ofgem does not remedy this issue, the cost base of the ESO will inexorably rise above the level it could be contained at if incentives existed. This comes at the very time when management discipline on costs is most necessary, because uncertainty creates more scope for inefficiency. This

[5] The Consultation, ESO annex, page 22, paragraph 4.10

cannot be in the interests of energy consumers. If Ofgem wishes to equalise incentives between internal and external ESO costs, which is one of the stated intents, it should set the same non-zero sharing factor on both.

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'?

37. Yes, we do, because some mechanism is better than nothing at all.

38. This type of mechanism will however do nothing to discourage the gradual growth of inefficiency in an ESO faced with a zero cost sharing factor and loose budgetary constraint. It creates ex post regulatory risk, and runs the risk that the company focuses primarily on justifying cost to the regulator rather than trying to manage them.

ESO innovation

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?

39. Yes, the proposals appear appropriate.

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

40. Yes, the ESO-specific issues that Ofgem notes in the Consultation, at paragraphs 8.11 to 8.14 of the ESO annex, are a reasonable set of issues to consider.

2. Gas distribution questions

41. Ofgem's proposals for gas distribution are extensive and relate to a sector of which we have no direct experience. They are also explicitly GD specific issues[6]. We therefore expect that they will not set any precedent for ED2, and offer only limited and generic feedback below.

Chapter 3 – meeting network user needs

General output questions

GDQ1. What are your views on the overall outputs package considered for this output category? And GDQ2. 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?

42. Our specific views, where we have them, are provided in response to the output specific questions below. We provide our general views in relation to outputs target setting in response to CSQ5, in the cross sector question annex to our response to the Consultation.

43. This generic framework is applicable to any sector. We have not tested the individual proposals against it, as sector specific considerations are likely to impact on the appropriate approach.

44. We note that there are many minor differences between the approaches to incentives in GD when compared to ED1. For example, looking at the GD1 customer service survey compared to the similar incentive in ED1:

   a. The GD1 survey is paper based and run by the GDNs, while the ED1 survey is telephone based and run by a third party survey provider.

   b. We understand the GD1 survey may be limited to customers acting in their capacity as a customer at a particular supply point, whereas the ED1 survey can also include people and businesses that require different types of service, not in the same capacity.

45. It would take a lot of resource to align the different sectors in respect of all of these small differences. This would distract this resource from the big challenges of the review.

46. Instead, Ofgem should work hard within the framework already offered by GD1 to develop a sound evidence base on which to set appropriate evidence based targets. Although some incremental

[6] As noted at paragraph 1.3 of the Consultation, Finance Annex

changes may be justified, the more changes that Ofgem makes, the more difficult it will be to appropriately calibrate the incentive targets.

GDQ3. What other outputs should we be considering, if any?

47. We have no specific suggestions.

48. As we highlight in our response to CSQ6, we caution against bespoke outputs, and highlight that a high bar should apply and that, if Ofgem does identify a bespoke output that is justified for one company, it is difficult to conceive why it would not be appropriate to apply it to all companies.

GDQ4. What are your views on the RIIO-GD1 outputs that we propose to remove?

49. We have no comments on the removal of the reporting and strategy requirements listed in table 35.

50. We doubt the environmental element of the discretionary reward scheme offers value, given the rewards will depend more on the submissions of the companies than outcomes.

51. We identified one proposal to remove a RIIO output that was not listed in table 35: Planned interruptions. We have three observations on this proposal.

    a. They cause inconvenience to consumers, and a financial value of the service interruption can be estimated; this should be quantified separately from any incentive relating to customer service during an interruption, as the two issues are distinct.

    b. It is not credible to argue that the relatively small associated incentive for each interruption would lead a GDN to risk breaching its safety obligations, which could result in major (multi million) fines.

    c. At ED1, faced with uncertainty over ongoing levels of planned interruptions, Ofgem moved the target to a rolling basis, with a lag of only a few years. This approach can help maintain incentives, while not exposing companies to undue risk.

Supplementary output specific questions

Consumer vulnerability

GDQ5. What activities beyond those outlined in paragraph 3.12 should we consider when defining the role of the network companies in supporting consumers in vulnerable situations?

52. We agree with Ofgem's overall stance of seeking to "avoid significant cross-subsidy" whilst funding "targeted company action to support consumers in vulnerable situations in the interests of fairness".

53. If the proposals Ofgem has set out for the GDNs were mirrored in electricity distribution, we would generally be supportive.

54. But in an electricity distribution context (and potentially a gas distribution context, dependent on Ofgem's duties in that sector) the proposals could be improved upon to:

   a. Strike a better balance between Ofgem's principal objective to protect the interests of existing and future consumers and its duty to have regard to the interests of those classes of persons set out in Section 3A(3) of the Electricity Act 1989 (the "Act"); and

   b. Incentivise companies to deliver enhanced services for vulnerable consumers.

GDQ6. Can you provide any evidence that shows how the boundary we have set out for the networks' role in consumer vulnerability could impact the benefits received by consumers in vulnerable situations?

55. In an electricity distribution context (and potentially a gas distribution context, dependent on Ofgem's duties in that sector) we believe that Ofgem can best meet its principal objective by ensuring that there is as little cross-subsidy as possible between any classes of persons in respect of the core services provided by the DNOs. The two core services being the duties under the Act to:

   a. Develop and maintain an efficient, co-ordinated and economical system of electricity distribution; and

   b. Provide connections to the network.

Consumer vulnerability use-it-or-lose-it allowance

GDQ7. What is your preference on the two approaches we have outlined to implement the allowance, and why?

56. We would not expect a use-it-or-lose-it allowance to be justified in this area and therefore neither approach is appropriate.

57. In an electricity distribution context (and potentially in a gas distribution context as well) our experience is that network companies are sometimes in the right place at the right time to improve outcomes for vulnerable consumers for a small amount of incremental cost. We work hard to identify and take these opportunities; for example ensuring call centre advisors or field staff can recognise vulnerability and take appropriate steps when they see it, such as putting vulnerable consumers in touch with people who can help. This integrated nature can make the cost of delivering a vulnerability offering difficult to track and report separately.

58. Rather than a use-it-or-lose-it allowance in this area it would be better to set clear requirements at the outset, as an outcome of the business plan incentive process, and an ex ante allowance (if there are any material costs that are not accommodated by the baseline allowances, which we would not necessarily expect).

GDQ8. What examples can you provide of initiatives that could be funded through the allowance, and please explain why these activities would not go ahead without specific price control funding?

59. To the extent that consumer vulnerability activities in gas distribution are similar to those we undertake in electricity distribution, we think this type of initiative is well-suited to funding through allowances. We can offer no examples that we think would not go ahead without a specific pot of price control funding, as long as Ofgem puts in place obligations for an appropriate level of service and allows adequate funding as part of baseline allowances to cover the efficient cost of delivery.

GDQ9. What is your preference on the three potential options we have outlined for a consumer vulnerability package, and why?

60. The options Ofgem has considered for developing a "consumer vulnerability package" contain the right mechanisms for improving the service companies offer to vulnerable consumers. However, we do not agree with Ofgem that Option 3: The Combined Package is the optimal solution. Instead, Ofgem should:

a. Set out any minimum requirements in the licence. To the extent these are required, they should be prescriptive.

b. Rely on the business plan incentive to ensure that companies offer enhanced ancillary services beyond the minimum requirements.

c. Set an ex ante allowance for companies to deliver these commitments, ensuring they are delivered as efficiently as possible.

Fuel Poor Network Extension Scheme

GDQ10. What should we include in the FPNES eligibility criteria in RIIO-GD2 to facilitate a well targeted, but effective scheme?

61. In an electricity distribution context (and potentially a gas distribution context, dependent on Ofgem's duties in that sector) we believe that Ofgem can best meet its principal objective by ensuring that there is as little a cross-subsidy as possible between any classes of persons in respect of the core services provided by the DNOs.

GDQ11. How should we incentivise the GDNs to improve the targeting of the FPNES?

62. Our views on this scheme are set out in response to CSQ10.

GDQ12. How can we ensure that the FPNES is better coordinated with other funding sources to provide a whole house solution for the household?

63. Our views on this scheme are set out in response to CSQ10.

GDQ13. What are your views on us requiring or incentivising the GDNs to ensure that households receiving FPNES connections also achieve a target level of energy efficiency?

64. Our views on this scheme are set out in response to CSQ10.

GDQ14. Do you think the value of the FPNES voucher would need to be amended if the targeting of the scheme is increased? Please provide any evidence to support your view.

65. Our views on this scheme are set out in response to CSQ10.

Guaranteed Standards of Performance

GDQ15. What is your preferred option for revising customer payment caps?

66. Option 1) is appropriate as a general approach, and the payment caps should be increased proportionately. Removal of any individual caps should be considered on a case by case.

67. We presume there were sound reasons to introduce the gas GSOP caps in the first place. These are unlikely to have changed.

68. Ofgem's pro and con assessment of the two options, in table 17, also omits to mention that Ofgem is considering an unplanned interruption incentive at GD2. This incentive would ensure that GDNs do not lose focus on effecting a restoration once a cap is reached.

69. Paragraph 3.122 of the Consultation also incorrectly says there are no payment caps in place for electricity distribution. In fact there are caps in the severe weather and 5,000 customers or more interruption standards. Presumably Ofgem means there are no payment caps in equivalent electricity standards. The electricity distribution standards were reviewed and revised recently, in 2015, and therefore Ofgem's option 1) (removal of all caps) would introduce misalignment with the results of an Ofgem review conducted only four years ago.

GDQ16. Where, within the consultation ranges, do you think the standard and payment levels should be set?

70. Payment levels towards the top of the range in the Consultation would be appropriate, if Ofgem is seeking some degree of alignment with the electricity distribution payment levels.

GDQ17. Should any existing GSOP exemptions be removed or changed and should any additional exemptions be considered?

71. No change appears appropriate from an electricity distribution perspective, as they are similar to the exemptions in place in electricity distribution. The electricity distribution standards were amended only four years ago and remain appropriate.

GDQ18. Do you support the proposal to make all GSOP payments automatic for RIIO-GD2 and why?

72. Automatic payments should not be required in relation to standards where there are significant barriers to making payments. We are not familiar with the specific details of the barriers that the Consultation mentions (at paragraph 3.132) in relation to gas distribution. However, our experience in electricity distribution is that they can be significant.

GDQ19. Are new GSOPs (or amendments to existing GSOPs) required and what might these look like?

73. We do not know the gas-specific detail, but Ofgem should:

    a. ensure it recognises whether incentives for good performance are in place when it considers if new GSOPs might be appropriate; and

    b. exercise caution on introducing GSOPs with very high service standards based on priority service register ("PSR") membership.

74. On the latter, although the PSR is effective in fulfilling certain requirements, eligibility criteria are wide enough that a high proportion of connected households could join. A rough estimate might be around half. Many of those eligible may be relatively affluent or need no special assistance. Materially higher GSOP service standards for PSR customers might result in badly targeted support.

GDQ20. Should there be a licence condition to prevent standards for the restoration of unplanned interruptions deteriorating (GSOP1)? If so, how should we set the target, and should we take into account geographical differences. Please consider alongside our wider proposed interruptions package.

75. No, Ofgem should instead retain a financial incentive on unplanned interruptions, and recognise that in certain circumstances, it might be appropriate for the operator to allow performance to get worse (if this would save significant cost, and therefore benefit consumers overall, for example).

76. If Ofgem sets a licence obligation to prevent performance getting worse, it may cause operators to maintain a level of performance that, taking into account the cost, is not in the interests of consumers.

GDQ21. Is the existing 90% target pass rate for connections GSOPs still appropriate, if not how should it be revised?

77. From an electricity distribution perspective, yes, it is still appropriate. Significant financial payments would be made to consumers under the standards before this 90% level is reached. It is appropriate that this requirement, which would result in licence breach if missed, is set at a level that is consistent with a backstop.

GDQ22. Should licence conditions with target pass rates be introduced for any other GSOPs?

78. No, they shouldn't. Guaranteed standards of performance ensure that, if service standards fell below certain levels, customers can receive some level of financial payment. Their statutory basis under the Act, in electricity distribution at least, is explicitly described in Section 39A (1) as being standards that "in the Authority's opinion ought to be achieved in individual cases". The only associated requirement is that a payment be made in the event of a failure to which an exemption from making a payment does not apply.

79. They are designed in a way that is appropriate for their purpose. They are therefore unlikely to be suitable as a basis for additional targets, incentivisation or licence requirements. Network companies that operate with guaranteed standards are also directly financially exposed to their performance under the guaranteed standards and so they already carry their own incentive, which is proportionate to the number of failures to which an exemption from making a payment does not apply.

Average restoration time incentive for total unplanned interruptions

GDQ23. What do you think of the proposed new output based on average restoration time for total unplanned interruptions?

80. Our general view on this type of incentive is that:

    a. The incentive rate should be calibrated using consumer willingness to pay.

    b. Ofgem should be willing to financially incentivise improvements in performance beyond the target where the cost to deliver improvements is lower than willingness to pay, otherwise consumers will be worse off than they could be.

GDQ24. Should any interruption events be excluded from the average restoration time incentive for total unplanned interruptions, and why?

81. Yes, where factors beyond the control of the GDN prevent restoration in specific cases, it would be appropriate to exclude these.

82. The data used for setting targets should be consistent with the data on which performance will be measured,

GDQ25. What are your views on separating interruptions that occur in MOBs into a specific output?

83. This is one possible approach. Alternatively, if these interruptions take longer to address, and different GDNs have a different mix of buildings, it may be appropriate either to:

    a. set GDN specific targets for aggregate interruptions within a single incentive; or

b. control for the differences by setting a different target for MOB interruptions and other interruptions, all weighted together to give a single target.

84. The target setting calculations for interruptions incentive targets at ED1 (and before) have used company specific figures for certain factors, and benchmarked levels for other targets, to create a single blended target. A similar approach may be possible in gas distribution, depending on data availability.

Chapter 4 – environmental sustainability

General output questions

GDQ26. What are your views on the overall outputs package considered for this output category? And GDQ27. 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?

85. Our specific views, where we have them, are provided in response to the output specific questions below. We provide our general views in relation to outputs target setting in response to CSQ5 [reference to other annex]. This generic framework is applicable to any sector.

86. We have not tested most of the individual proposals against it, as sector specific considerations are likely to impact on the appropriate approach.

87. When Ofgem removed the electricity distribution losses incentive, it replaced it with a licence duty to ensure that losses are as low as reasonably practicable. This ensures that DNOs must take losses into account in their investment planning and decision taking. Replacing the GD1 shrinkage incentive with this type of licence condition at GD2 would ensure GDNs continue to consider the impact of asset replacement and repex activities on their modelled shrinkage levels, and take this into account in decision making (as well as all other relevant factors). In circumstances where shrinkage is not known, only modelled by the licensee, a similar licence condition may achieve shrinkage outcomes as good as the current modelled financial incentive.[7]

GDQ28. What other outputs should we be considering, if any?

88. We have no specific suggestions for additional outputs.

[7] At ED1 a losses discretionary reward scheme was also introduced. We would not recommend this approach for ED2 or GD2, as it acts to reward submission quality more than underlying actions.

89. As we highlight in our response to CSQ6, we caution against bespoke outputs, and highlight that a high bar should apply and that, if Ofgem does identify a bespoke output that is justified for one company, it is difficult to conceive why it would not be appropriate to apply it to all companies.

GDQ29. What are your views on the RIIO-GD1 outputs that we propose to remove?

90. At GD1, many reporting requirements or (in some cases) deliverables were described as outputs. They were not RIIO outputs (i.e. outcomes). It is appropriate that they be removed.

91. As a general point on discretionary reward schemes, they inevitably reward the quality of submissions as heavily as the underlying activity, and therefore are generally good candidates for moving into licence obligations (if appropriate) once the activities they identify can be codified.

GDQ30. What are your views on the priorities we've identified for the gas distribution sector in delivering an environmentally sustainable network? Should measures proposed for electricity and gas transmission, such as BCF reporting and strategies for including in Business Plans, also apply to gas distribution? In addition to the above questions, where relevant, please the see the supplementary output specific questions below.

92. Ofgem's proposals appear reasonable, including the proposal to apply business carbon footprint reporting requirements to GDNs, which already form part of the ED1 arrangements.

Supplementary output specific questions

Decarbonisation of heat

GDQ31. Do you agree with our proposed approaches to funding GDN activities over RIIO-GD2 related to Heat decarbonisation?

93. We support the least cost approach to heat decarbonisation.

94. We agree with Ofgem that it is premature to design an output around hydrogen conversion. We can however see the reason for a reopener to cater for any change in government heat policy that had a material impact on GDN funding requirements.

95. In terms of anticipatory investments, we set out our general views in response to CSQ42. Ofgem is right to maintain a high bar for specific incremental funding. Instead:

   a. Baseline price control funding should be focussed on approaches with low (or even no) incremental cost, like our ED1 smart grids enablers funding. Our plan was cheaper, per customer, than the BAU operational telecoms and IT costs some other DNOs proposed at ED1.

   b. Ofgem's comparative totex cost benchmarking should give GDNs an ongoing incentive to undertake investment that is anticipatory of the relatively distant future when there is an opportunity to do so. We regularly do so, for example where we reinforce assets, and choose a larger cable size, or when we provide a new connection and fund larger than necessary assets ourselves.

96. This framework provides appropriate discipline on investment decisions and is in the interests of consumers.

Distributed Gas Connections Guide and distributed gas information strategies

GDQ32. Are the GDNs' Distributed Gas Connections Guides and distributed gas information strategies helpful and effective? If not, how could they be improved?

97. Ofgem's proposals to retain the guides seem reasonable, assuming prospective bio-methane connectees confirm they are useful.

98. We also support Ofgem's view that it should not socialise connection costs associated with grid expansion. If prospective connectees face the cost of their connection, then they will internalise this cost, and will go ahead if the project is cost benefit justified. If they did not face the cost of their connection, inefficient projects would go ahead, that cost society more than they are worth.

Chapter 5 – maintaining a safe and resilient network

General output questions

GDQ33. What are your views on the overall outputs package considered for this output category? And GDQ34. 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?

99. Our specific views, where we have them, are provided in response to the output specific questions below. We provide our general views in relation to outputs target setting in response to CSQ5. This generic framework is applicable to any sector.

100. We have not tested most of the individual proposals against it, as sector specific considerations are likely to impact on the appropriate approach.

GDQ35. What other outputs should we be considering, if any?

101. We have no specific suggestions for additional outputs.

102. As we highlight in our response to CSQ6, we caution against bespoke outputs, and highlight that a high bar should apply and that, if Ofgem does identify a bespoke output that is justified for one company, it is difficult to conceive why it would not be appropriate to apply it to all companies.

GDQ36. What are your views on the RIIO-GD1 outputs that we propose to remove? In addition to the above questions, where relevant, please the see the supplementary output specific questions below.

103. At GD1, many reporting requirements or (in some cases) deliverables were described as outputs. They were not RIIO outputs (i.e. outcomes). It is appropriate that they be removed.

104. As a general point on discretionary reward schemes, they inevitably reward the quality of submissions as heavily as the underlying activity, and therefore are generally good candidates for moving into licence obligations (if appropriate) once the activities they identify can be codified.

Supplementary output specific questions

Repex

GDQ37-41

105. We make a number of general points we make on the need for Ofgem to avoid micromanagement in our responses to CSQ4, at paragraphs **Error! Reference source not found.** to **Error! Reference source not found.** above.

106. It would be far better for Ofgem to set strong incentives for companies to submit plans with challenging cost levels, along with a strong incentive for them to manage costs in the period, than to rely on input regulation to ensure a certain amount of activity takes place. Consumers will be better off paying less than funding unnecessary work.

NTS exit capacity

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?

107. We have no specific views on the details of the incentive, which is applied to on an activity which we do not undertake.

108. Ofgem's direction of travel, towards better understanding the potential GD2 scenarios and calibrating the incentive structure and targets, does however appear to be appropriate. This type of regulatory development should materially reduce the prospect of un-earned outperformance in the GD2 period.

109. Ofgem mentions an uncertainty mechanism for adjusting targets in light of peak demand. To maintain strong incentives, this type of uncertainty mechanism should be based on factors that are measurable, outside the control of DNOs, and capable of being specified ex ante.

GDN record keeping

GDQ43. Do you consider that an output(s) is necessary: a) for MOBs record keeping (in the form of a bespoke Price Control Deliverable)? b) for other specific areas of GDN record keeping (if so which areas)? c) to cover GDN record keeping requirements as a whole?

110. We are not familiar with the area of work, but it appears to be ideally suited to a licence obligation[8], coupled with strong incentives for GDNs to submit challenging cost forecasts for meeting this obligation in their business plans, and then strong incentives to efficiently manage their costs.

111. Instead what Ofgem proposes sounds like micromanagement. We make a number of general points we make on the need for Ofgem to avoid micromanagement in our responses to CSQ4, in the cross sector question annex to our response to the Consultation.

Chapter 6 – cost assessment

GDQ44. Do you agree with our intention to evolve the RIIO-GD1 approach for RIIO-GD2?

112. We understand that cost benchmarking decisions will be undertaken on a sector specific basis, reflecting the different characteristics of different network sectors.

113. In general, however, we do not think that the RIIO-1 approach to benchmarking should offer the default template for RIIO-2 and, if it is used for GD2, this must not set precedent for ED2. If Ofgem does use the GD1 models as a start-point GD2, it should carefully inspect those models, and in particular the disaggregated models, for any regulatory distortions that they might cause, and work hard to reduce or eliminate these.

GDQ45. Do you have any comments on our initial views for cost assessment, including appropriate cost categories, cost drivers, analysis toolkit and how we combine the analysis?

114. Where possible, cost assessment should use totex benchmarking, plus an assessment of value for money offered over successive price control periods, to encourage companies to make efficient cost trade-offs. Totex benchmarking was given a significant role in the RIIO framework to mitigate distortions that can otherwise arise between different categories of cost; Ofgem should consider a more prominent role for it in GD2.

115. Turning to ED2, we think a significant role for top-down totex benchmarking is even more important than in the past, to give DNOs the strongest possible incentive to propose the cheapest solutions, and make use of new approaches to managing network issues, rather than allowing the inevitable distortions associated with disaggregated benchmarking to have a major impact on the results.

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[8] If the activity in question is necessary for GDNs to meet their safety obligations, as regulated by the HSE, then a licence obligation would not be necessary. The HSE is better placed to specify the requirements, and can levy significant fines for serious non-compliance.

116. As well as totex benchmarking, Ofgem needs the tools to heavily scrutinise high-cost parts of poor value plans, as part of a genuine proportionate treatment process. The existing GD2 models might not give it these tools.

117. Other network sectors are unlikely to offer easy comparators for GD2 business support costs as no variable can defensibly be used to control for differences between the sectors. We have considered these comparisons, as a tool for benchmarking our own costs, and found we could make no commercial use of it. They offer a poor regulatory solution.

118. Northern Powergrid continues to believe that cost benchmarking could place greater emphasis on long term value for money. This could be achieved through a comparative totex benchmark of the costs that the companies charged to consumers in the last period, in addition to the normal totex benchmark of the costs that companies propose to charge in the next.

119. We are happy to work with Ofgem further if this is a solution it would like to see developed, either for T2 and GD2 or later for ED2.

120. For GD2, Ofgem has proposed a sound set of principles for evaluating cost drivers. Ofgem needs cost drivers that are relevant, complete and outside of company control.

121. Many cost drivers Ofgem used at RIIO-1 were within company control to some extent, and should be re-considered at RIIO-2.

122. Ofgem should not use network deliverables (such as health indices) in cost assessment as this would move Ofgem further into micromanagement, and because the condition assessments that feed the measures are heavily influenced by discretionary company judgements (and also by past investments, disadvantaging companies that have maintained their networks well).

GDQ46. Do you have any views on our proposed options for loss of metering work?

123. Ofgem has a duty to finance costs efficiently incurred costs in the delivery of activities which are the subject of obligations placed on the companies it regulates.

124. Whether or not Ofgem provides any funding should depend on its assessment of whether the ongoing costs associated with this activity are efficient. If they are, Ofgem must fund them.

125. It should also set strong incentives for GDNs to submit the lowest cost forecasts, and then maintain the incentives for cost minimisation within the period. Its proposals for the business plan incentive and within period incentives will not achieve this.

GDQ47. Do you agree with our proposal for implementing symmetrical adjustments for regional or company specific factors?

126. We agree that Ofgem should maintain a high bar for making regional adjustments, because every network company faces issues that will raise its costs relative to other companies, and because all parties (including the other networks) face asymmetries of information when assessing them.

127. Ofgem is right to maintain the option to make asymmetric regional adjustments (for instance where the evidence base is uncertain), giving a company some allowance for a factor, while not penalising others for this allowance (as they may face an even worse asymmetry of information than Ofgem).

Chapter 7 – uncertainty mechanisms

General uncertainty mechanism questions

GDQ48. What are your views on the proposed uncertainty mechanisms and their design?

128. In general, uncertainty mechanisms should be set based on external triggers and factors, wherever possible, rather than the actions of the companies Ofgem regulates, in order to maintain strong incentives.

129. The uncertainty mechanisms Ofgem lists that it proposes to retain or add at GD2 appear reasonable. However, Ofgem is also proposing a multitude of deliverables associated with clawback mechanisms in various parts of its proposals. The RIIO handbook guidance on price control deliverables is clear that, when deliverables reach the point that they are used to adjust allowances, an uncertainty mechanism should be set instead. Ofgem's proposals therefore, in effect, include many uncertainty mechanisms that are not listed. They are specified in many cases seem to amount to input regulation and micromanagement rather that controlling for external factors that GDN's cannot control.

130. In terms of the gas specific mechanisms listed, we have the following observations:

a. A smart meter re-opener is only necessary if the costs are material **and** there is substantive uncertainty over the GD2 period. It is not clear either of these conditions will be satisfied for GD2, but it is more likely for ED2.

b. The heat policy re-opener is sensible. Similar reopeners for major government policy decision will also be appropriate for ED2.

c. A reopener for changes in HSE policy is sensible.

d. The suite of repex uncertainty mechanisms appear to be driven by the desire to ensure reductions in cost due to efficiency savings can be clawed back, and a move to micromanagement of workload delivery. This will markedly weaken incentives for the companies and raise costs to consumers over the long term.

131. At GD1, Ofgem highlighted disapplication as an uncertainty mechanism. The fact gas operators have the right to disapply within the price control period originates from a drafting error with its roots in the Transco restructuring. The error was extended to electricity transmission at T1. When requested, Ofgem decided not to provide the same rights at ED1. Given Ofgem concluded at ED1 that this disapplication right should not be replicated, and given it had previously stated (in the 2000s) that it would correct this issue at some stage, it should be corrected for GD2 and T2.

132. The ED1 licence carries the original and correct form of the disapplication right, which ensures networks face strong incentives to contain costs by not providing them with the right to disapply until the end of the price control period. Its original intent was to cater only to the unlikely eventuality that Ofgem might fail to reset the price control at the end of the period, when it should.

GDQ49. Are there any additional uncertainty mechanisms that we should consider across the sector and if so, how should these be designed?

133. We have no views on other potential uncertainty mechanisms for DG2.

GDQ50. What are your views on the RIIO-GD1 uncertainty mechanisms we propose to remove? In addition to the above questions, where relevant, please the see the supplementary uncertainty mechanism specific questions below.

134. From an electricity distribution perspective, our views on the uncertainty mechanisms proposed for removal are that:

a. It seems appropriate to remove the streetworks reopener given the limited remaining uncertainty.

b. We are not clear that fuel poor network extensions are consistent with Ofgem's duties and stance that it should minimise cross-subsidy.

c. The connection charging boundary is set in the Act in electricity distribution, and we have never considered it necessary to have a re-opener as a consequence.

d. There have been various uncertainty mechanisms in relation to shared use connection costs in ED in DPCR5 and ED1, but not a reopener.

e. We see limited use in the IRM, as set out in our response to CSQ45.

Supplementary uncertainty mechanism specific questions

Review of Agency (Xoserve) costs

GDQ51. What do you think is the most appropriate approach for funding the GTs' expenditure for Xoserve in RIIO-2 and why?

135. We have no views on this issue.

GDQ52. 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?

136. We have no views on this issue.

3. Gas Transmission questions

137. Of those sectors being consulted on, Gas Transmission is the most distant from electricity distribution.

138. Our general views in response to the main consultation questions are applicable directly to gas transmission. Our responses to a number of questions in the electricity transmission annex may be generically applicable to transmission sectors, and so may be relevant to gas transmission. These questions include:

a. bespoke outputs (ETQ3);

b. stakeholder engagement incentives (ETQ5);

c. customer surveys (ETQ16);

d. cost assessment (ETQ63-ETQ67); and

e. uncertainty mechanisms (ETQ68).

139. Other than this, we provide no views in response to the GT2 only questions.

4. Electricity Transmission questions

Chapter 3 – meeting network user needs

General output questions

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

140. Our specific views, where we have them, are provided in response to the output specific questions below. We provide our general views in relation to outputs target setting in response to CSQ5. This generic framework is applicable to any sector.

141. We have not tested the individual proposals against it, as sector specific considerations are likely to impact on the appropriate approach.

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

142. We have no specific suggestions for additional outputs.

143. As we highlight in our response to CSQ6, we caution against bespoke outputs, and highlight that a high bar should apply and that, if Ofgem does identify a bespoke output that is justified for one company, it is difficult to conceive why it would not be appropriate to apply it to all companies.

144. The "timely connections" output at ET1, which was applied to the Scottish TOs but not NGET, is a good example of this principle in action. Ofgem is now proposing that the output be extended to all TOs. If an output is worth having, it should almost certainly be applied to all companies in the same sector.

ETQ4. What are your views on the RIIO-ET1 outputs that we propose to remove?

145. We provide our views in response to the output specific questions, below.

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 reputational or financial.

146. After securing a step change in stakeholder engagement, and provided that Ofgem is content that it can make proper allowance for the costs of delivering an effective baseline standard of engagement in all companies, this incentive mechanism can now be removed. Ofgem correctly describes the issues with this type of incentive.[9] Our experience is that the assessment of regulatory submissions (such as on stakeholder engagement), to calibrate a financial reward or a reputational incentive:

   a. Carries significant administrative costs; and

   b. Ultimately results in a subjective assessment that depends heavily on submission quality which, in turn, will depend on the reward weighting individual companies gain.

147. This means the resulting incentives may end up being flawed and calibrated in ways that are not in the interests of consumers over the longer term. They can however serve a time limited purpose where a step change is necessary, to reveal new forms of good practice, provided that:

   a. Once new forms of good practice these are identified the requirements should be transitioned to licence obligations (with the costs incorporated into business as usual allowances), and the incentive removed.

   b. The maximum potential financial reward for each company should be a fixed value, to the extent that the costs of "entry" do not scale with size, so larger companies do not have an incentive to dedicate more resource (e.g. management interest, external design consultancy, preparation time) to the process, skewing the results.

148. The decision on whether it is appropriate for the incentive to be removed is a sector specific one, but we propose the removal of similar incentives at ED2, and think that it is likely to be a good candidate for removal at ET2.

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?

149. We have no specific observations in response to this question, beyond our response to ETQ5.

[9] The Consultation, Electricity Transmission annex, paragraph 3.28

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

150. The commitments should be reputational, as the core price control framework should ensure consumers are protected. The business plan commitments should be developed through company business planning processes and stakeholder engagement. Progress against these commitments should be reported on annually. The business planning process, and five-yearly plan quality assessments, can serve as an ongoing process to reveal improved ways of working with stakeholders which, if appropriate, can later be translated into obligations for all companies.

151. Common standards that all companies should meet are best defined in licence obligations.

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?

152. The incentive per company should be a set value, at least to the extent that the costs of participation are fixed. As we highlight at paragraph 147.b, all companies participating in the reward scheme should face the same potential reward, in absolute terms, at least to the extent that the costs of developing quality "new" stakeholder engagement ideas, and plan submission quality, which heavily influence the assessment, do not scale with company size or revenue. If larger companies face bigger potential rewards for this type of activity, they will have an incentive to dedicate more resource to their submission, and this will skew the results towards them.

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?

153. We have no specific views on this at this time.

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

154. We have no specific views on this at this time.

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

155. This proposal seems reasonable. From an electricity distribution perspective we are aware of no reason to move away from this approach.

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?

156. We provide our general views in relation to outputs target setting in response to CSQ5. This generic framework is applicable to any incentive.

157. As we highlight in our response to CSQ91, Ofgem should undertake detailed scenario analysis on the potential outcomes, based on the available evidence, and set targets which it expects to result in an accurate settlement.

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?

158. We have no specific views on this at this time.

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?

159. These financial incentives sound like they may be suitable for removal or transition to licence obligations.

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?

160. If Ofgem considers this output is appropriate for the Scottish TOs, it should be extended to NGET.

161. As we highlight in our response to ETQ3, and CSQ6, it is difficult to conceive of circumstances where it would be appropriate to apply a bespoke output to only one or a sub-set of network companies in a sector. If the output is in the interests of consumers in one part of the country it will almost certainly be in the interests of consumers in another part of the country.

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?

162. We agree with Ofgem that it should not consider a mechanism like the ED1 incentive on connections engagement ("ICE") for application at ET1.

    a. There are direct parallels between how the mechanism works in ED1 and how it would work in ET1, since the most active participants seeking the application of penalties in the

ED1 mechanism are not domestic consumers or small businesses, but are in fact other electricity distributors (IDNOs).

b. This mechanism is deeply flawed, since it is open to abuse by large organisations seeking preferential treatment that is not in the interests of energy consumers.

c. The same problems would arise in electricity transmission.

d. Licence obligations placed on TOs and the ESO, set by Ofgem, are a more appropriate way to manage this type of commercial interaction.

e. We propose the removal of the ICE at ED2, transitioning any necessary requirements that it has highlighted as good practice into licence obligations if necessary.

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?

163. We have not identified any at this time.

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?

164. We have no specific views on this at this time.

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.

165. Yes, this incentive should be retained. In doing so, Ofgem should:

a. Set an evidence based target that it expects to result in an accurate settlement.

b. Ensure the incentive operates on both sides of this level, by applying both a penalty and a reward.

c. Set an incentive rate based on the value of lost load, objectively measured in respect of events that result in transmission energy not supplied (“ENS”), and then scaled down by multiplying by the company sharing factor.

166. This is regulatory best practice for an incentive scheme where the impact on consumer outcomes can be objectively quantified. It is well targeted and proportionate. It ensures companies will

optimise their investments, their operational restoration, and the outage risks they carry, improving on ENS if it is cost benefit justified, or letting it worsen if it is not.

167. It appears to be aligned to Ofgem's initial view.[10]

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?

168. As we highlight in our response to CSQ5, Ofgem should not engage in perpetual benchmarking of performance on a year-to-year basis to adjust targets.

   a. If it sets comparative targets, it should set fixed targets at the outset that it expects will result in an accurate settlement, and reset these once every five years.

   b. If it is regulating individual companies, with no comparators, it should consider either fixed or rolling targets (with a sufficiently long 'lag' that companies face a strong incentive to prevent performance delivering), in a way it expects to result in an accurate settlement.

169. Ofgem is also proposing a return adjustment mechanism as a backstop. It does not need additional adjustment mechanisms for individual incentives. To apply them would undermine the incentive itself, and lead to worse outcomes for consumers.

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

170. We provide our relevant views in response to CSQ5. Any improvement factor should be evidence based.

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

171. We have no further views beyond those we set out at ETQ19 above.

ETQ23. Do you agree with our proposals to base the ENS incentive rate in RIIOET2 on an updated, agreed VoLL?

172. This appears to be appropriate. We have not however reviewed the specific analysis and projects that Ofgem cites in the Consultation.

[10] The consultation, electricity transmission annex, paragraph 3.80

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

173. This appears to be appropriate.

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

174. We have no specific views on this at this time, but the principle appears to be appropriate.[11]

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?

175. We see no reason that the distribution and transmission incentives should necessarily use the same measure. Transition to a different approach would also carry risks.

176. The consultation notes potential issues with applying a customer interruptions and customer minutes lost ("CI/CML") framework to transmission, specifically that it may lead to the same weight being placed on a "large" connectee as a domestic user. There are many relevant factors to consider, for example:

a. larger connectees often have backup generation so they can keep their critical processes running, limiting the value of lost load to them well below;

b. the value of lost load tends to be measured directly, so in distribution these measures had to be converted to CI/CML; and

c. if Ofgem changes the basis of the measure materially at T2, rather than making small incremental improvements, it will have significantly less understanding of likely performance in the T2 period from the available historical data, making it harder to set accurate targets.

177. Overall we are doubtful that a major change like this would be appropriate in the short time available before T2, and it may not be appropriate even over the longer term.

[11] We assume that electricity transmission companies, or the ESO, have all the necessary data. If however Ofgem believes that electricity distributor insight and data may assist in developing an appropriate measure for the transmission incentive scheme, then this could be explored through a specific policy working group involving electricity distributors, or a questionnaire for electricity distributors.

178. If the outcome of this policy consideration is to move to a CI/CML framework, we will be happy to work with Ofgem and transmission operators to overcome any barriers to us gathering the relevant information in an appropriate format.

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'?

179. We have no specific views on the transmission measures.

Chapter 4 – environmental sustainability

General output questions

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

180. Our specific views, where we have them, are provided in response to the output specific questions below. We provide our general views in relation to outputs target setting in response to CSQ5, in the cross sector question annex to our response to the Consultation. This generic framework is applicable to any sector.

181. We have not tested the individual proposals against it, as sector specific considerations are likely to impact on the appropriate approach.

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

182. We have no specific suggestions for additional outputs.

ETQ32. What are your views on the RIIO-ET1 outputs that we propose to remove?

183. We generally support the removal of discretionary reward type incentives, and therefore support the removal of the environmental discretionary award at ET2. These rewards involve significant administrative efforts, and the results can be heavily influenced by the presentational exercise used as a basis for reward judgements. It is however appropriate for companies to be held accountable for their environmental impact through other appropriate and proportionate means, and funded accordingly, which will lead to better outcomes overall.

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?

184. We think they should be embedded in business plans. We assume many costs of addressing environmental impacts in transmission will be embedded within business as usual. In these circumstances it is difficult to see how these activities could not be embedded in business plans.

185. Ofgem talks in the consultation about potential mechanisms for returning unspent allowances. Where there is uncertainty over requirements, based on factors beyond companies' control, Ofgem should put in place an uncertainty mechanism triggered by those external factors. Assuming that companies deliver the outcomes requested and agreed at the time of the price control Ofgem should not seek to clawback unspent allowances. This would result in distorted incentives, and remove the incentive for companies to seek cost savings. Like many of the proposals Ofgem has made in the Consultation, it will lead to a loss of productivity and costs will rise as a consequence, making consumers worse off.

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.

186. We have no specific views on the environmental impact categories that would be appropriate for transmission.

187. We agree with Ofgem's view that the low-carbon incentive proposed by Sustainability First is unlikely to provide better value to consumers that the proposals on which Ofgem has consulted.

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

188. We have no specific views on this in the context of transmission.

Potential for bespoke ODIs around the low carbon transition

ETQ 36-38.

189. As we highlight in our response to ETQ3 (above) and CSQ6 (in the cross sector question response to the Consultation), it is difficult to conceive of circumstances where it would be appropriate to apply a bespoke output delivery incentive to only one (or to a sub-set) of network companies in a sector. If the output is in the interests of consumers in one part of the country it will almost certainly be in the interests of consumers in another part of the country.

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

190. We doubt that there are any justifiable bespoke ODIs. If justified ODIs are missing from the overall proposals, it is likely that they should be applied to all transmission operators. In spite of differences between the networks, they are all undertaking the same activity: the transmission of electricity.

191. The suggestions for what such ODIs could capture listed at paragraph 4.35 are all worthy but they all relate to things that would:

a. create growth opportunities for companies;

b. save money that companies could retain a share of; or

c. overlap with another part of the framework, for instance innovation or whole system arrangements

192. There is no reason to have an ODI for any of these, as they are all already catered to by various incentives.

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.

193. The overriding factors Ofgem should take into account are that, if it puts in place bespoke ODIs:

a. it will make the settlement more complex;

b. the settlement will be made more likely to "leak value" through inaccurate targets; and

c. costs that are not justified based on consumer benefits may be incurred.

194. If an additional ODI is appropriate for one TO, it is likely to be appropriate for all of them.

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.

195. If SF6 leakage can be directly, objectively and accurately measured it is a good candidate for direct financial incentivisation. Whether or not a financial ODI should be applied will depend on sector specific considerations.

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

196. Our views are essentially the same as those we set out in relation to ENS in paragraphs 165 to 166 above.

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

197. If other insulation and interruption gases (IIGs) do not have the same damaging environmental impact as SF_6 then including their leakage in the measure could lead to perverse incentives and:

a. discourage the development and deployment of alternative IIGs, strongly if the leakage rates of the alternative tend to be higher for any reason; or

b. over-incentivise leakage prevention for assets with alternative IIGs if the environmental consequences of this leakage are negligible by comparison with SF_6.

198. If the roll-out of these alternative IIGs was reasonably predictable, the declining volume of SF_6 of the system (and therefore declining volume of leakage) could be recognised in declining leakage targets.

199. If however there is material uncertainty over the scale and timing of roll out of low environmental impact IIGs, Ofgem will have to consider carefully how to set targets for SF_6 leakage.

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

200. This will depend on sector specific considerations. In general, exclusions may be appropriate if:

a. there is significant volatility, or material risk, associated with the events; and

b. the factors that lead to the events, and their duration, cannot reasonably be mitigated by the transmission operator.

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?

201. We agree with the considerations Ofgem raises in relation to losses, and why it is not appropriate to put in place a financial incentive.[12]

202. If one is not already in place in electricity transmission, Ofgem could also consider a licence obligation, similar to the licence obligation in place on DNOs, to ensure losses are as low as reasonably practicable. This would oblige TOs to recognise losses in their decisions, where they can affect losses, going beyond a reputational only incentive because licence obligations are enforceable.

[12] The Consultation, Electricity Transmission Annex, paragraph 4.70-4.71

203. The proposals for a reputational incentive based on business plan commitments and annual reporting on progress against these commitments, is aligned to the approach we take as part of ED1.

204. We agree with Ofgem that an incentive like the losses discretionary reward would not add value, including at ED2.

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?

205. The Consultation provides relatively limited details at this stage. Any proposals should be cost benefit justified. Whether they are, or not, will depend on the cost of additional metering, and steps to reduce losses, and the potential losses reduction payoff.

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.

206. Business plan commitments in this area, and annual stakeholder reporting against these commitments, may be an appropriate way of ensuring transparency and maintenance of a reputational incentive.

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?

207. Updated analysis on willingness to pay would be helpful to help inform evidence based decision taking on the scheme.

208. We do not believe it is necessarily appropriate to limit undergrounding to cases where it would not be possible to obtain planning permission for an overhead line based on today's planning standards. For example:

a. The *incremental* cost of undergrounding a new line, compared to building an overhead line, will be significantly lower than the cost of undergrounding a pre-existing line; therefore even if the visual amenity benefit is lower, undergrounding a new line might be better justified.

b. Consumer willingness to pay may indicate that undergrounding is justified in some cases where planning permission would be granted, if planning decisions do not fully capture this consumer willingness to pay.

c. Whether or not planning permission can be gained may potentially depend on factors like whether there are pre-existing lines nearby (depending on planning rules). This may prevent gradual removal of infrastructure because the presence of multiple lines may mean new lines could gain planning permission.

209. Willingness to pay information may also help justify removal of any distortion between funding to underground existing infrastructure and new infrastructure. To ensure the funding is targeted, it should be possibly to deploy it flexibly based on relevant evidence of amenity priorities.

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

210. We have no specific views on the funding approval process in transmission.

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

211. We agree with Ofgem that it should have regard to its duties.

Chapter 5 – maintaining a safe and resilient network

General output questions

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

212. Our specific views, where we have them, are provided in response to the output specific questions below. We provide our general views in relation to outputs target setting in response to CSQ5. This generic framework is applicable to any sector.

213. We have not tested the individual proposals against it, as sector specific considerations are likely to impact on the appropriate approach.

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

214. We have no specific suggestions for additional outputs.

ETQ52. What are your views on the RIIO-ET1 outputs that we propose to remove?

215. We provide our views in response to the output specific questions, below.

Supplementary output specific questions

Network Access Policy (NAP)

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

216. We support Ofgem's proposed approach to safety, which recognises the HSE's role as the safety regulator.

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

217. This proposal appears to be appropriate, in the context of the challenges listed in the Consultation brought about through the separation of system operation and transmission asset ownership, such as the fact that the ESO bears constraint costs that can be affected by transmission operators.

218. The examples also highlight why the RIIO model as applied to distribution leaves DNOs ideally placed to take on the role as DSO. The costs incurred by the DSO in managing constraint costs would be treated in exactly the same ways as the costs of undertaking new investment under the main price control allowances, thanks to the equalised incentive and capitalisation rates. There would also be no barriers to appropriate information sharing.

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?

219. We have no specific views on the consolidated NAP at this time.

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

220. The Consultation mentions that the ESO has hitherto been able to compensate the Scottish TOs for providing the ESO with services to reduce constraint costs, but not NGET, and that these rules are being adjusted.[13] Now that legal separation of the ESO is being completed, it seems appropriate to allow the ESO to compensate NGET for the cost of providing such services. The two entities will be legally separate, and this change would remove an obvious distortion in the treatment across different parties.

221. Expanding the NAP to cover interactions with non-transmission operators (such as DNOs or generators) may represent one option for a framework to cover the growing role of DNOs providing services to the TO, it would not be the only option. There is already an existing commercial framework that allows DNOs to provide services to the ESO (or the TOs). This area may also interact with the whole system licence obligation.

[13] The Consultation, Electricity Transmission Annex, page 61, paragraph 5.21

222. Since Ofgem's RIIO-2 methodology consultation explicitly states that it is not setting out proposals for the electricity distribution sector at this stage. [14] Ofgem should consult on this question as part of ED2, or via a separate process targeted to the issue.

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?

223. Where companies are unable to deliver needed infrastructure according to agreed timelines, and where consumers suffer detriment, we agree that there is no case for allowing for a reward.

224. However, this does not make the case for Ofgem's proposals, which amount to micromanagement of company decisions and appear to reflect a desire to dampen incentives and the possibility of outperformance. The proposals are simply not consistent with the RIIO framework.

225. Instead, under the RIIO approach to regulation, or indeed any approach that recognises best regulatory practice, Ofgem needs to take the following approaches:

   a. put in place uncertainty mechanisms, to cater to external events that the company cannot control, that are triggered based on the occurrence of those external events; and

   b. ensure the company faces incentives that reflect the costs its decisions or performance impose on consumers;

226. In the case of major transmission projects, for example a new £1billion line, it would certainly be appropriate for Ofgem, or the company through its business plan, to develop a set of uncertainty mechanisms and incentives. In this example:

   a. The uncertainty mechanism could allow allowances for that project, and that project alone, to be re-profiled to reflect delays caused by external factors, including manufacturing challenges.

   b. The incentives could expose the company to the consumer cost it causes, for example in the form of higher constraint costs, if its own serious performance deficiencies lead to the delay (with these incentives being "turned off" in relation to external factors, if the uncertainty mechanism is triggered).

227. Cases where Ofgem simply provided the allowances, with no such provisions, in the T1 price control do not showcase RIIO. The tools were not used.

228. Simply switching off any incentive for companies to delay or defer expenditure is inappropriate and not in the interests of consumers. For example, where companies are able to delay the need for some piece of planned infrastructure by taking cheaper actions elsewhere, or by responding to new

[14] The Consultation, Executive Summary, page 8, paragraph 1.16

information, it would be wrong for Ofgem to remove any and all financial benefit from taking those steps.

229. Ofgem's proposals would remove any incentive for companies to depart from their plan, across the board, and highlights Ofgem's move towards micromanagement and desire to remove incentives.

ETQ58. We invite views on the suitability of the milestone approach, the types of milestones or delivery criteria we should be considering and any potential challenges associated with implementing such an arrangement.

230. Ofgem should recognise in its thinking that:

a. There is a significant difference between those instances where delays do not raise whole-system costs to consumers and those where they do.

b. Sometimes delaying projects can lead to consumer benefits, for example where the need is delayed, and later investment will result in newer assets that last for longer. Ofgem recognises that this means there should be no reward for early delivery.[15] Yet the same issues apply where the requirement for a project is appropriately delayed; companies should be incentivised to deliver later, so the savings can be shared with consumers, yet Ofgem proposes to remove this incentive and therefore promote early delivery.

c. Companies should not be penalised for the sake of delays to one large project where they also bring ahead another large project (or several smaller ones), as this would distort incentives for largely offsetting investment plan rebalancing that may be a very sensible response to potential delays.

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

231. Major investment projects may warrant case by case assessment at close out.

232. Ofgem should not remove timing benefits for major projects if these reflected effective asset management decisions taken by the company and led to consumer benefits.

ETQ60. We invite views on the circumstances we should consider options for minimising consumer detriment and/ or sharing consumer detriment with consumers. And ETQ61. We are seeking views on these two options, including ways in which we could measure and reflect consumer detriment.

233. Many factors can lead to delays on major investment projects that are beyond the reasonable control of the company undertaking the investment project.

[15] The Consultation, Electricity Transmission Annex, pages 63-64, paragraph 5.38

234. Ofgem should not expose companies to penalties on account of factors that are beyond their reasonable control.

235. However, where factors are within company control, incentives may be appropriate.

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

236. We have suggested variations on Ofgem's proposed approach in response to ETQ59 and ETQ60.

Chapter 6 – cost assessment

ETQ63. Do you agree with our intention to evolve the RIIO-ET1 approach for RIIOET2?

237. We understand that cost benchmarking decisions will be undertaken on a sector specific basis, reflecting the different characteristics of different network sectors.

Our experience in electricity distribution means that, in general, we do not think that the RIIO-1 approach to benchmarking should offer the default template for RIIO-2.

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

238. Our experience of cost benchmarking is rooted in a sector where top down totex benchmarking is possible. We recognise that it will be more difficult, or even impossible, in transmission due to a lack of available comparators.

239. Bottom up disaggregated benchmarking may therefore be necessary in transmission. Ofgem should recognise the damaging distortions this can create, and the fact that, by necessity, it means that it will be more dependent on each company's plan.

240. Ofgem needs tools to heavily scrutinise high-cost parts of poor value plans, as part of a genuine proportionate treatment process. The existing T1 models will only be suitable for T2 if the give Ofgem these tools.

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

241. We have no specific views on whether these proposed cost categories are appropriate for ET2 cost assessment.

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

242. Ofgem has proposed a sound set of principles for evaluating cost drivers. Ofgem needs cost drivers that are relevant, complete and outside of company control.

243. Based on our perspectives from distribution, many cost drivers Ofgem used at RIIO-1 were within company control to some extent, and should be re-considered at RIIO-2. We also consider that Ofgem should not use network deliverables (such as health indices) in cost assessment as this would move Ofgem further into micromanagement, and because the condition assessments that feed the measures are heavily influenced by discretionary company judgements (and also by past investments, disadvantaging companies that have maintained their networks well).

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

244. In light of this, Ofgem's proposed approach of not pre-defining weights across bottom up approaches appears to be appropriate in a transmission context.

245. Taking an average across multiple approaches represents no solution if those approaches do not all reflect efficient costs. It may be better to rely on a single set of results that Ofgem considers is most likely to be accurate, or to set the best long term incentives, than to introduce weighting on other approaches. Ofgem will have to judge its own analysis on its merits, once it has seen that analysis.

Chapter 7 – 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.

246. Many of the issues that the uncertainty mechanisms apply to are covered in the Consultation's main document and we do not cover them again here.

247. Ofgem highlights disapplication rights as an uncertainty mechanism that it proposes to retain at ET2. The fact that gas operators have the right to disapply within the price control period originates from a drafting error with its roots in the Transco restructuring. The error was extended to electricity transmission at T1. When requested, Ofgem decided not to provide the same rights at ED1. Given Ofgem concluded at ED1 that this disapplication right should not be replicated, and given it had previously stated (in the 2000s) that it would correct this error at some stage, it should be corrected for GD2 and T2.

248. The ED1 licence carries the original and correct form of the disapplication right, which ensures networks face strong incentives to contain costs by not providing them with the right to disapply until the end of the price control period. Its original intent was to cater only to the unlikely eventuality that Ofgem might fail to reset the price control at the end of the period, when it should, and allow the existing price control formula to continue to operate instead.

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

249. Ofgem has not mentioned finance uncertainty mechanisms, such as the established cost of debt index. The specification of the cost of debt index is dependent on the expected level of RAV growth, since this will influence the share of new (cheap) debt in the sectors' financing, and consequentially Ofgem's calibration of the index.

250. If there is significant uncertainty over the level of RAV growth (for example because Ofgem may later choose to allocate certain transmission projects to competition) it should consider designing a cost of debt index that is sensitive to this uncertainty. For example, if projects are allocated to competition that were initially forecast for the main price control, the transmission operators will have a smaller debt portfolio, which contains less new debt, on which their costs will be higher.

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.

251. We have no specific views on the operation of these mechanisms in the electricity transmission sector beyond those we set out in response to ETQ69 and ETQ70 above.