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Dear Akshay

Ofgem Call for Evidence – NGET’s views on the RIIO-2 Challenge Group Report

We have reviewed the RIIO-2 Challenge Group Report on energy network companies’ business plans (the “Report”), which was published on 24 January. This letter provides our views on the Report, which we are submitting to you as part of your call for evidence for the open hearings.

This letter covers our views on both the company specific commentary, the RAG status assessment for each company and the steps we believe Ofgem should now take to fully assess the submitted Business Plan.

Our views on the Company Specific Commentary

The Report acknowledges that the group has been unable to look at the evidence in detail and recommends Ofgem undertakes more detailed scrutiny. We fully support this recommendation as the detail is important and conclusions cannot be reached without a full and proper understanding and consideration of the evidence. We are concerned that despite acknowledging the group did not review the detail, the Report, in some areas, still offers definitive opinions. In the section below we identify where we believe there is a high risk of a misunderstanding or misrepresentation of our proposals in the Report, which we want to highlight to interested stakeholders and Ofgem, as it is important to us that Ofgem and interested stakeholders understand both our proposals and the rationale behind them.

Our uncertainty mechanisms are there to protect consumers by providing a flexible framework

We are concerned that the Challenge Group has misunderstood the purpose of uncertainty mechanisms. The Challenge Group appears to have given higher scores to companies proposing fewer uncertainty mechanisms than those proposing more.

We support Ofgem's view that flexibility is crucial at this time of considerable uncertainty to avoid the price control being a barrier on the route towards net-zero greenhouse gas emissions. Indeed, the uncertainty mechanisms we propose in our business plan are intended to provide just that flexibility and the challenge group has not provided any commentary about their effectiveness in that light nor alternatives to achieve the same end which could be better for consumers.

We look forward to engaging further with Ofgem on the detail of our proposals and the rationale behind them, as we are confident that our proposals are in the best interests of consumers and are critical to achieving net zero at the lowest cost for consumers.

We have taken a supportive, proactive approach to competition in our plan

We strongly support increased competition in electricity transmission because of its potential to deliver benefits for consumers. The Challenge Group has not fully understood our commitment to competition or the extent to which our business plan is subject to competition. We have identified three projects for early competition and four projects for late competition in our business plan, worth £5bn in total. The Challenge Group appears to only have acknowledged the late model candidate projects and criticises us for not putting these in our baseline, but this is intentional to show our commitment to competition by not requesting baseline expenditure for projects that competitors might carry out.

The Challenge Group says we should have been more proactive in identifying projects for competition that fall below the Ofgem criteria. The group does not recognise the additional 50 projects, worth over £1bn, in our plan that will effectively be subject to competition through the Electricity System Operator (ESO) assessing them against non-network and whole system alternatives. The specific example that the Challenge Group gives of an area we could have considered for competition, generator connection sole works, is already open to competition because customers can already choose third parties to build their connections.

We have taken a proportionate approach to engineering justification reports

At several points in its report the Challenge Group criticises us for providing EJPs that are too generic and not focussed on specific assets (for example on page 7 of the report). We recognise that the other two electricity TOs have provided asset-specific EJPs, but this is because they have a much smaller number of projects in their plans, reflecting their smaller sizes. We have tens of thousands of assets in our RIIO-2 plan and taking a similar approach to the other TOs would have involved more than 2,000 EJPs. Producing this many EJPs would not be an efficient use of consumers' money, nor would it help the Ofgem teams analyse our plan. The proportionate approach we took has been discussed and agreed with Ofgem early in 2019.

We will, however, make sure that you have access to the vast amount of detailed condition information that we have for our specific assets and the engineering and technology options that are available to replace them. We are already working closely with your engineering and cost assessment teams to make sure they have access to the necessary data, information and rationale to address the concerns the Challenge Group has raised.

We have proposed a stable and sustainable financial framework

In our business plan we set out the importance of creating a financial framework that benefits consumers through appropriately balancing risk with reward, demonstrating regulatory commitment to a stable regime, taking a long-term sustainable approach and providing strong incentives. At several points in its report the Challenge Group makes comments that, if implemented, would in our view make it more difficult to achieve these objectives, to the detriment of customers and consumers.

For example, in assessing the financeability of network companies' business plans the Challenge Group has assumed that BBB, rather than BBB+ is an appropriate credit rating threshold. This would represent a break from regulatory precedent and decrease the level of financial resilience and the stability of the UK's energy networks at a time when increases in investment are required to deliver the UK government's net-zero target.

We also advocate a broader assessment of financeability than the Challenge Group proposes. Such an assessment should focus on a range of debt financeability metrics (rather than just Moody's metrics) and include an assessment of equity financeability, which the Challenge Group has dismissed. Without this broader view it is not possible to make sure the financial framework is sustainable over the long term.

Finally, we note that the Challenge Group advocates a greater level of consumer engagement in relation to our financial framework. While this is a difficult area to engage on, we will explore opportunities to further engage with consumers on this topic.

The Challenge Group acknowledges it has been unable to look at the evidence in detail and recommends Ofgem undertakes more detailed scrutiny

The Challenge Group has acknowledged it has been unable to look at the evidence contained in the Business Plan in detail and recommends that it needs Ofgem, with its larger resources and longer period for review, to consider our business plan in more detail. In the annex to this letter, we identify 43 examples of where the Challenge Group asks Ofgem to carry out more detailed analysis of issues that are relevant to NGET. We believe conclusions should only be drawn once this detailed assessment has taken place.

Ofgem required network companies to complete its extensive, complex and detailed business plans data templates (BPDTs) that Ofgem has pre-defined and which requires expert analysts to interpret correctly. The tables are accompanied by 352 pages of Regulatory Instructions and Guidance (RIGs) providing detailed guidance and definitions for the tables. We do not recognise, and have been unable to replicate, much of the analysis that is contained within the Challenge Group Report and as such we have concerns about the conclusions drawn in the Report.

A specific example of where a deeper understanding of our plan would avoid drawing incorrect conclusions is on page 36 of the report, where the Challenge Group says the Ofgem BPDTs we completed for our company suggest we are moving to more refurbishment than replacement, but with little evidence to support this. However, the +346% highlighted in

red in Table 16 (page 36) mostly reflects that Ofgem has changed the definition of these categories between T1 and T2. Where we propose refurbishment as an option, we provide evidence in the associated engineering justification papers (EJPs) and cost benefit analysis (CBA) of how this compares with replacement.

We believe Ofgem and interested stakeholders should be mindful of the comments above in reading the conclusions drawn in the Challenge Group Report and, as recommended by the Challenge Group, we look forward to engaging with Ofgem in depth in the areas, to ensure that Ofgem's assessment is based on a full and proper understanding and consideration of the evidence.

The Challenge Group's scoring system is unclear and there are inconsistencies in the scores across companies

We have not found in the Challenge Group's report the objective criteria the group has used to score and compare the companies on a 5-point red/amber/green scale on the 13 categories relevant to our December plan. We have found numerous examples where different companies have taken similar approaches, but the Challenge Group has given them significantly different scores. The objective reasons for these differences are not clear.

We are keen to discuss with Ofgem the areas where we believe the rationale for the scores are unclear, to ensure that the proposals in our Business Plan are fully understood.

Next steps

We recognise that Ofgem is taking the various reports it has received as inputs to its detailed evaluation process. As you are aware, we have already started working with your teams to help them understand the detailed justification and data underpinning our business plan and I would be grateful if you, as part of that process, review in detail the areas highlighted in the Challenge Group Report (summarised in the annex), so that conclusions are reached with a full and proper understanding and consideration of the evidence.

If you have any queries about this response, please do not hesitate to contact either Mark Brackley or myself.

Kind regards
Chris Bennett

[by email]

Director, UK Regulation

Annex - Areas the RIIO-2 Challenge Group says Ofgem should look at in more detail

The RIIO-2 Challenge Group report asks Ofgem to look at our business plan in more detail in many areas.

In the table below we identify 43 examples of where the Challenge Group has asked Ofgem to carry out more detailed analysis of issues that are relevant to NGET. 15 of the examples come from the cross-company sections of the report and 28 from the NGET-specific part of the Challenge Group report.

Page reference	Area that the Challenge Group says Ofgem should look at in more detail
Cross-company sections of the report	
5	Cyber resilience plans “merit particularly close scrutiny by Ofgem.”
7	“We recommend that Ofgem carries out significant further analysis” of engineering justifications and Cost Benefit Analysis.
8	“Ofgem will need to evaluate and benchmark the total package of [CVP] outputs offered by each company, rather than focusing on individual proposals”
24	“We suggest that Ofgem does this to ensure the [ENS] targets are equally stretching”.
31	“Overall, based on the limited time we have had to review these, we think that NGGT and NGN have provided better defined and more limited uncertainty mechanisms, and we have increasing degrees of concern about the other companies. However, we expect Ofgem to validate and assess all these proposals, taking account of potential bias to the company’s benefit.”
34	“We are concerned that some companies have proposed uncertainty mechanisms such that their baseline Totex costs can be reduced, or have used output measures to justify why costs should be included in Totex. [...] We would welcome further analysis by Ofgem teams regarding the alternative approaches that companies may have taken.”
35	“We are concerned by the overall level of expenditure on IT, cyber and associated costs by a relatively mature industry. The level of expenditure and means of delivery needs further examination by the Ofgem teams.”
36	“We think these costs and volumes [NGET’s NLRE and unit costs] are considerably higher than necessary and ask Ofgem to examine these in more detail.”
43	“We would welcome further analysis by Ofgem in considering the alternative approaches that companies have taken in these areas [IT costs, uncertainty, outputs and costs].”

45	“We would like to have seen specific [NGET] EJPs, asset condition reports, and CBAs for what are individually significant expenditure proposals, and recommend that Ofgem reviews these when they are made available.”
46	“Given the limited time we have had to examine these [engineering] justifications: we will rely on the further examination by the Ofgem teams.”
47	“We commented to companies about compliance with Ofgem’s WAs in relation to their July and October plans but have not, in the time available, been able to make a full assessment of that compliance in relation to the December plans (which will obviously be checked by Ofgem).”
48	“The determination of the appropriate Cost of Capital allowances is a matter for Ofgem at the time of the Final Determination but we have thought it appropriate to take note of, and comment on, the alternative proposals presented by companies”.
54	“On the basis of the limited time and information available to us we have not felt able to comment on the appropriateness of proposed methodologies for quantification of CVP proposals and would recommend that Ofgem has regard to the scrutiny which the CEGs and User Groups were able to do in this area.”
55	“We suggest that Ofgem should benchmark these [complete CVP offerings] between networks (and in some cases also against other utility companies)”
Section of Challenge Group report on NGET	
102-103	“We suggest that Ofgem explore this qualified consumer response [on acceptability] with NGET at the Open Hearings as well as exploring the extent to which acceptability testing with consumers in future could take account of the total impact of energy costs on consumers’ bills.”
103-104	“We suggest that Ofgem carries out a more detailed cross-company comparison of targets in this area [of Energy Not Supplied] to ensure that they are appropriate and equally stretching.”
104	“Given the relative newness of the NARM process, and the difficulties in data verification, it is important that Ofgem works with the company to confirm the robustness of those projections and is able to track physical changes in the Business Plan over the RIIO-2 period.”
105	“We also support NGET’s proposed PCD, to install Wide Area Network monitoring under “Meeting the Needs of Consumer and Network Users”, but suggest that Ofgem review the cost of £48m, and the delivery programme, to ensure that this output is delivered efficiently”.
105	“NGET have forecast high levels of investment for IT and cyber security. Due to confidentiality requirements, we have been unable to review this evidence and rely on Ofgem to examine these costs and the resilience provided.”

106	“We recognise that there is some evidence of stakeholder support for those programmes [of SF ₆ reduction], but would urge Ofgem to take full account of the cumulative impact on bills and decarbonisation benefits when considering the programmes”
106	“We think it is important, therefore, so far as all the other outputs listed on the Environmental Outputs Scorecard go, for Ofgem to confirm that NGET propose to deliver them in the normal course of implementing their investment and operating cost budgets, and have not included any additional funding requests.”
108	“NGET are also proposing to work with Ofgem to establish a “whole system” automatic adjustment mechanism, and we would again suggest independent validation of any proposal.”
111	“We have not sought to reconcile these different cost categories (which will be a matter for Ofgem’s analysis) but have focused on the justifications for expenditure in the NGET Plan as detailed below.”
111	“We have considered the engineering evidence for interventions, cost benchmarking and asset health information but expect Ofgem to undertake more detailed analysis in this area.”
113	“Based on this comparison, it would appear that unit costs are increasing for circuit breakers, cables and reactors, compared to RIIO-1 actuals. [...] we would suggest these are explored further by Ofgem.”
114	“Cables and cable tunnels – NGET propose to invest £862m in RIIO-2, representing a doubling in annual expenditure and a 30% increase in volume. [...] We have not reviewed them in detail and are looking to Ofgem to challenge the scope and costs”
114	“The remaining cable spend on substation cables is justified based on asset health data. Unit costs vary significantly across the three large projects due to specific factors, and we suggest these are reviewed by Ofgem.”
115	“In December we received a significantly amended EJP, stating that site-specific assessments have been made, and quantifying the contribution to the NARM delta-risk output target as r£48.1m. We remain unconvinced and Ofgem will need to confirm the cost and risk assessments in due course.”
115	“At our request, NGET provided a list of specific circuit breaker assets for intervention, in the EJP accompanying the December Plan. We have not however seen site specific data to justify the circuit breaker or bay asset interventions, so it will be for Ofgem to confirm those in due course.”
115	“At our request a list of circuits for intervention and risk model data were added to the December submission, and a description provided of the available asset condition data. Ofgem however are better placed to assess those than we are.”
116	“NGET provided a graph of the expected percentage of intervention by circuit, with a range of 10%-90%. We have not seen detailed condition reports, and

	therefore recommend that Ofgem probe the assumptions on the residual life of those fittings being replaced, versus those being left in situ. For the latter, we suggest Ofgem also probe the condition data and CBA assumptions to ensure a cost legacy is not being stored up for future customers.”
116	“We would suggest that Ofgem consider the proposed number of interventions, and given the scope to combine site works across different overhead line activities, challenges the significant rise in unit costs.”
116	“Of particular note are cost increases of 70% in LV boards. We would suggest Ofgem review the volumes and unit cost assumptions, and support including volumes delivered in the non-lead asset PCD.”
117	“We have not examined this confidential element of the Plan [Cyber and telecoms resilience] but would ask Ofgem to examine whether this and other IT and telecoms expenditure is justified as terms of being additional to BAU, type of intervention, unit cost and volume, and that it is not duplicated elsewhere in the Plan.”
118	“It is unclear why additional expenditure above BAU is required for protection studies, facilitating competition, and optimising the network with other parties. [...] If, after review, Ofgem decides to include ex-ante allowances or UMs for such costs, we agree that they should be tied to clear PCDs, and would like to see them agreed with the relevant other parties.”
119	“Overall, we found expenditure in the NGET Plan to be weakly justified and have identified the following areas of concern for Ofgem to probe further.”
120	“For other expenditure that we have not considered in detail (especially IT costs), we ask Ofgem to examine the justifications against RIIO-1 BAU expenditure. We are concerned that NGET has built a significant risk margin into its cost forecasts that may be removed later to the company’s benefit.”
120	“Assuming baseline RIIO-2 load related Totex of some £500m (or £100m p.a.) for generator/demand connections is included for RIIO-2, this would result in a baseline Totex of about £5 billion compared to NGET’s £7 billion proposal. We suggest that Ofgem considers whether this approach might be applied.”
120	“Was it previously claimed under RIIO-1? We think that a number of the NGET NLRE investments appear to have been deferred from RIIO-1 and would ask Ofgem to investigate further.”
121	“For lead assets, it is important that customers can be confident in the NARM output measure and we would suggest that Ofgem focuses on this.”
124	“As regards improvements to natural capital [...] we think that the best proposals across the sector may warrant recognition but that these will need to be benchmarked carefully and the interaction with the ODI if allowed (we do not support it for reasons noted above) taken into account”
124	“CVP 1 Optimisation of harmonic filtering: this proposal could remove barriers to entry for smaller generators and therefore make a valuable contribution to facilitating the low carbon transition by helping renewable schemes to come

	on stream more quickly. We queried whether the proposal might prevent the emergence of a competitive market or lead to distortion in the renewable generation market and recommend that Ofgem should consider these issues”
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