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### **Consultation on Managing network charge bad debt**

Dear Mick,

Thank you for the opportunity to respond to Ofgem's open letter consulting on a proposal for managing network charge bad debt.

The ESO is participating in the Network Charge Deferral Scheme (NCD) which allows eligible suppliers to defer Transmission Network Use of System (TNUoS) charges between July-September to be fully repaid by March 2021. The scheme is being fully funded by National Grid Electric Transmission and Scottish Hydro Electric Transmission with ESO holding the bad debt risk.

We welcome the introduction of a term in the ESO RIIO-2 licence for bad debt recovery enabling networks to recover potential bad debts arising from COVID-19 related deferred network charge payments and to introduce an enduring solution to bad debt recovery in general. We agree that network companies should follow best credit control practices to recover any debt before it is passed on to consumers via this term.

We agree that of the three options set out in the Ofgem open letter, option 3 provides an enduring solution to recover bad debts and allows for recovery of NCD bad debt. We will work with Ofgem on the detailed licence drafting and development of the Regulatory Instruction Guidelines (RIGs) through the RIIO-2 licence drafting workshops. The RIGs would include among others clarification on trigger points for forecasting bad debt as well as definitions of best practice.

We note option 3 does not propose a change to the RIIO-1 licence conditions but proposes to reflect an estimate of potential RIIO-1 bad debts in the RIIO-2 final determinations specifically for bad debts that crystallise during the RIIO-2 price control. We believe the definition should, in addition, include bad debts that crystallised in the RIIO-1 period as the ESO has no RIIO-1 mechanism to recover these debts. The value included in the final determinations should be inclusive of the appropriate time value of money adjustment.

Please see below our responses to the specific questions asked in the open letter.

#### **Q1: Do you agree that our proposals would allow the recovery of bad debts, by network licensees, relating to Network Charge Deferral scheme (COVID-19) in 2021-22?**

As stated above, we welcome the introduction of a term for bad debt recovery into the RIIO-2 licence per the recommended approach.

The timescale indicated in the letter shows the intent to recover NCD bad debt in 2021-22.

Specifically, we note that Ofgem will direct the RIIO-2 licence and the Price Control Financial Model (PCFM) in January 2021 which will include the bad debt value submitted by the licensee in early January 21. The inclusion of the bad debt term in the allowed revenue calculated via the PCFM will enable the ESO to include a value in the Balancing Services Use of System (BSUoS) charges for 2021/22. The use of estimated values provided by the licensee, which is trued-up in the following period through RIGs reporting, will enable licensees to forecast bad debts that they anticipate crystallising in 2021/22.

Currently, the TNUoS allowed revenue is not published via a PCFM direction but calculated by the ESO. We do not believe that the TNUoS bad debt term needs to be directed. We welcome discussions with Ofgem on the inclusion of the bad debt value in the calculation of the TNUoS allowed revenue.

We agree that the networks should be kept whole as a result of the NCD schemes. However, the open letter refers to the recovery of NCD bad debt covering the value of debt deferred (up to 75%). We believe that should the remaining 25% result in bad debt, this would be covered under 'other bad debts incurred due to non-payment of network charges'. We would welcome clarification from Ofgem on this.

We also agree that consumers should benefit from any interest accrued by networks due to the NCD scheme. We note that Ofgem propose to adjust any bad debt recovery with the interest accrued by the network companies, net of the cost of capital. For the TNUoS NCD scheme the ESO will be charged interest by the TOs therefore the interest adjustment will have to reflect this arrangement. Therefore, we propose, for transparency, that the interest earned on deferrals resulting from NCD is included as a separate term within the RIIO-2 licence drafting. This will also enable clarity of drafting for the enduring solution as the term can be switched off.

**Q2: Do you agree with the introduction of a pass-through term in the RIIO-2 licence as an enduring solution for the recovery of bad debt?**

We agree with the introduction of the pass-through term in the RIIO-2 licence as an enduring solution. Whilst the open letter refers to bad debts arising from non-payment of TNUoS and BSUoS charges being incurred by the ESO, the ESO has other charges which carry a similar bad debt risk. The recovery of bad debt term should be extended to include other charges as well as TNUoS and BSUoS, for example Site-Specific charges (DIS) or Transmission Owner Final Sums charges (TS) as defined in the RIIO-1 ESO Licence. TNUoS charges are currently recovered from generators and suppliers. The current drafting does not consider generator bad debt and therefore for the ESO the enduring solution should cover potential default by generators as well as suppliers.

As noted in Q1, the RIIO-2 licence drafting needs a separate term for the interest earned on deferrals resulting from NCD which can be switched off for the enduring solution.

Appendix 2 of the open letter includes an indicative timeline for the enduring solution. We note that the timeline includes a step which is notification to Ofgem of a bad debt value in Jan 22 (and each subsequent year). The timeline indicates that BSUoS charges will be set to recover the published November allowed revenue as adjusted for the bad debt value provided in January. The RIIO-1 licence includes an obligation, which we expect to be replicated in the RIIO-2 licence, that the licensee must use its best endeavours to ensure that the revenue collected by the licensee from the Balancing Services Activity associated with internal costs does not exceed the calculated allowed revenue. In RIIO-2 the allowed revenue will be published by Ofgem in November as calculated in the PCFM. If we set charges based on the published allowed revenue adjusted for the bad debt submission in January, we will be setting charges to recover more than the PCFM calculated allowed revenue and potentially breach the obligation. We do not believe that this is Ofgem's intent and therefore propose that the bad debt forecast is included in the published November allowed revenue.

As noted in Question 1, currently the TNUoS allowed revenue is not published by Ofgem but calculated by the ESO. We do not believe that the TNUoS bad debt term needs to be directed for the enduring solution. We welcome discussions with Ofgem on the calculation of the TNUoS allowed revenue.

As noted above, option 3 does not propose a change to the RIIO-1 licence conditions but proposes to reflect an estimate of potential RIIO-1 bad debts in the RIIO-2 final determinations specifically for bad debts that crystallise during the RIIO-2 price control. We believe the definition should, in addition, include bad debts that crystallised in the RIIO-1 period as the ESO has no RIIO-1 mechanism to recover these debts. The value included in the final determinations should be inclusive of the appropriate time value of money adjustment.

We welcome the opportunity to further discuss the points raised within this response. Should you require further information or clarity on any of the points outlined in this paper then please contact me.

Yours sincerely,



Gregg Smith

Finance Director, National Grid ESO