nationalgrid

National Grid House
Warwick Technology Park
Gallows Hill, Warwick
CV34 6DA

Mr P Branston
Associate Partner, Gas Networks
Ofgem
9 Millbank
London
SW1P 3GE

Richard Court
Head of UK RIIO Delivery
richard.court@nationalgrid.com
Direct tel +44 (0)1926 65 3626
www.nationalgrid.com

4th March 2016

Dear Paul and Mick

**Mid Period Review issues raised by other stakeholders**

We note that some concerns have been raised by other stakeholders in response to Ofgem's mid period review consultation. In addition to our own response to the consultation which provided our views on the questions Ofgem set out, we have taken the opportunity to review the comments raised by other stakeholders and provide some additional information below with regard to;

- Comments raised associated with RPEs

- The comment around lack of information to judge or assess mid period review requirements; and

- Evidence on how both the Capacity and Broad Measure of Customer Satisfaction is designed.

*Real Price Effects*

We have previously provided feedback to Ofgem regarding the quote in Ofgem's first year RIIO performance report regarding a £600m favourable variance against the RPE assumptions in the RIIO allowances. We stated that we could not replicate this analysis. We have provided some analysis to Ofgem on 23rd February to show our understanding of some of the movements in RPEs in our networks. This shows that there has not been a material favourable variance in RPEs compared to the original allowances.

*Regulatory Information*

As part of RIIO we have published detailed cost and performance material for the first and second year of RIIO together with our extensive Mod 186 reports and a breakdown of the customer bill. We also have Stakeholder Days where a range of stakeholders including consumer groups, Suppliers and Shippers have been invited and where we have discussed and reviewed our performance.

*Capacity Incentive*

For the Exit Capacity Incentive, the challenges have been;

- GDN are incentivised to book at more expensive offtakes
- GDNs appear to have significantly changed their approach to delivering their 1:20 peak day obligations
- The use of forecast prices can create inappropriate incentive rates.
- The incentive is delivering poor value for money for customers.

We have looked at the capacity incentive to determine if it drives us to book at more expensive Offtakes and this is not the case.   When physically possible due to network configuration across our offtakes, the incentive encourages the GDN to book capacity at the lowest cost Offtakes and reduce bookings at expensive Offtakes.

The capacity incentive has been in place for the GDN's since 2005 after the sales of the networks. This was to ensure that NTS was acting fairly across all the connectees to the transmission system. The framework was agreed in collaborative forums including all vested parties. Baselines across the NTS were set and then reviewed in 2008, this set the theoretic maximum for the capacity requirements on the NTS that the GDNs were funded to deliver. User commitment was then required if you exceeded these maximums.

Our predicted demand scenarios since the incentive came into effect has risen and fallen due to a number of factors, one influence being the Composite Weather Variable. This factor is reviewed by the industry every 5 years and changes feed into the demand scenarios. Each network can source its own view of demand and therefore the views across the GDN's do vary.

For National Grid Gas Distribution, we utilise the demand scenarios provided by National Transmission under the Future Energy Scenarios. We also have the provision to adapt the axioms to reflect our own views of demand behaviour for our networks.

Our bookings have reduced over time and reflect, where possible without incurring user commitment, utilisation of the cheaper offtakes. Our changes across our offtakes are informed by our control rooms operation, utilisation of cheaper offtakes and the ability of the network to transport the gas to the centres of demand. There are limitations to flexing bookings, due to the original baselines being set in 2008, the prices across the NTS were different at that time. If we were to exceed the baselines and incur a user commitment any further change in price could not be responded to until the user commitment was paid, without over booking.  This is because the user commitment locks the capacity at the offtake as well whilst the user commitment remains in place.

This has occurred in the West Midlands, original prices favoured the north of the network and after the addition of the Milford Haven LNG site the prices favour the south. We maximize our bookings to the south where we can within the baselines.

Our current strategy looks to utilise the cheaper offtakes within baseline restrictions and the limitations of the network but also use the daily products to access day ahead gas with no additional charge to the customer. Balancing the need to cover our peak day commitments and accessing all of the products available in the most cost effective way. Utilising the inherent flexibility in some of our networks we have reduced our bookings, in East Midlands, North London and West Midlands. East Anglia LDZ and North West network have lower linepack flexibility and the addition of new loads has reduced our opportunity to lower our bookings.

It is appropriate to use forecast prices as consideration for either changes to the network or the use of other products, such as interruption requires time to respond to within the market. It is therefore appropriate to drive the incentive from this. If we are able to reduce our capacity bookings, this in turn releases capacity for Transmission to provide to other system users.

In terms of the comments made regarding a comparison of cost saved and allowance changes, there were differences in the way the initial allowances were set with regard to NTS prices at the start of RIIO across the GDNs. We have attached Ofgem's decision letter which set out how the base revenue were adjusted in National Grid and SGNs networks at the start of RIIO but the other networks were not. Given the different true ups, this makes comparisons of changes in allowances and prices difficult and hence why it may look like there is not an equivalent change.

*Broad Measure of Customer Satisfaction*

For the Broad Measure of Customer Satisfaction, it is important to note that customer expectations increase year on year in terms of the level of service they expect. The benchmarks for customer satisfaction and complaints handling were set based on upper quartile levels of performance for the sector and when compared to other industries they require high levels of customer satisfaction. For example it is acknowledged amongst customer service institutions that 9 out of 10 is regarded as a 'world class' level of service. Hence the calibration of the incentive mechanism which requires excellent levels of performance before rewards are achieved and penalises service that drops below this standard seems consistent with its intent.

*Stakeholder Incentive*

It has been acknowledged that there has been a step change in networks' stakeholder engagement activities and the evidence from the incentive submissions illustrates that there are some significant outputs that have resulted from that engagement. The guidance from Ofgem's independent stakeholder Panel ensures that the networks continue to improve their engagement activities and indeed the results from the second year of the incentive show that networks need to demonstrate step change improvements to maintain their previous incentive outcome. Hence we would suggest this incentive is working as intended and is providing good outcomes for customers.

I hope you find these comments useful.

Yours sincerely

Richard Court
Head of UK RIIO Delivery