

## Mid-period review decision

### Final decision

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#### Overview:

The RIIO-T1 price control provides for a mid-period review of output requirements. In May 2016 we decided to launch an MPR for RIIO-T1 and look at certain outputs for National Grid Electricity Transmission and National Grid Gas Transmission.

In August 2016 we set out our minded-to position to change outputs and associated funding. After considering stakeholder responses we have made our decision to reduce National Grid's allowances across gas and electricity by £185 million.

We have decided to remove National Grid Gas Transmission's Avonmouth pipelines output and £168.8 million in funding, as the pipelines are no longer required. We have also decided to reduce National Grid Electricity Transmission's allowances by £16.6 million. This reflects a reduced requirement to protect sites against rising fault levels (lowering allowances by £38.1 million) and new requirements relating to the new enhanced system operator role (increasing allowances by £21.5 million).

## Context

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RIIO-T1 and GD1 were the first price controls to reflect the RIIO (Revenue = Incentives + Innovation + Outputs) model. The RIIO-T1 price control sets the outputs that the electricity and gas transmission network companies need to deliver for consumers and the associated revenues. Similarly, the RIIO-GD1 price control sets these for gas distribution companies. We have also launched the RIIO-ED1 price control for electricity distribution, which runs on a different timetable.

The RIIO framework is designed to promote smarter gas and electricity networks for a low carbon future. RIIO price controls emphasise incentives to drive the innovation needed to deliver a sustainable energy network that offers value for money to existing and future consumers. The RIIO framework allows for a mid-period review (MPR) of outputs halfway through the price control.

In May 2016, we published our decision to launch an MPR for certain areas of the RIIO-T1 price control for National Grid Electricity Transmission and National Grid Gas Transmission.

In August 2016 we set out our minded-to position to change outputs and funding. We have considered stakeholder responses and decided largely to maintain our position.

## Associated documents

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[Consultation on the mid-period review \(MPR\) of RIIO-T1](#)

[Decision on a mid-period review for RIIO-T1 and GD1](#)

[Consultation on a potential RIIO-T1 and GD1 mid-period review \(and associated responses\)](#)

[RIIO-T1: Final Proposals for National Grid Electricity Transmission and National Grid Gas](#)

[For Initial Proposals, strategy decisions and the RIIO Handbook, please see our dedicated page for RIIO-T1.](#)

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## Executive Summary

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The RIIO price control framework includes a number of uncertainty mechanisms. One of these is the mid-period review (MPR) of outputs.

The MPR mechanism was put in place to allow for material changes to outputs where there have been clear changes in government policy or consumers' and network users' needs. It enables the introduction of new outputs and the removal of outputs that are no longer required.

We launched an MPR for the RIIO-T1 price control focusing on specific areas, all of which relate to National Grid's outputs (both gas and electricity transmission).

We have now made a decision to reduce National Grid's allowances across gas and electricity by £185 million.

As National Grid Gas Transmission (NGGT) no longer needs to build pipelines in Avonmouth, we have decided to remove the output and £168.8 million in associated funding. We have also decided to reduce National Grid Electricity Transmission's (NGET) allowances by £16.6 million. This reflects a reduced requirement (£38.1 million less) to protect sites against fault levels and increased funding (£21.5 million more) for new activities related to the new enhanced system operator role.

**The Avonmouth pipelines output** was included in RIIO-T1 to help manage the consequences of the Avonmouth liquefied natural gas (LNG) storage facility closure. NGGT confirmed that the pipelines are no longer required and that it does not propose to build them.

We have decided to remove the pipelines output and no longer hold NGGT accountable for delivery. We will also lower NGGT's allowance by £168.8 million<sup>1</sup> to remove the amount allowed for the pipelines output.<sup>2</sup>

**The Enhanced system operator role for NGET** includes obligations arising from the Integrated Transmission Planning and Regulation (ITPR) project, this includes improving system planning and the annual delivery of the Network Options Assessment report. We also support NGET's introduction of additional balancing services products to help NGET balance the system given lower forecast margins and introduction of a new service to promote the market for demand-side response. We want to ensure that efficient costs for the system operator are appropriately funded

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<sup>1</sup> All allowances are expressed in 2009/10 prices so that they are consistent with the RIIO-T1 final proposals.

<sup>2</sup> The amount originally allowed for the pipelines is £169.0 million. NGGT has spent £0.2 million on technical and strategic analysis of options for managing the consequences of the closure of the Avonmouth LNG terminal. We will retain an allowance for this expenditure.

given the continuing development of new services and the need to ensure the system is effectively managed.

We have decided to provide £21.5 million in additional funding to reflect the efficient costs of providing these additional services which were introduced after we set RIIO-T1.

**We have also considered NGET's outputs to protect nine sites against rising fault level currents and install 11 shunt reactors.**

NGET originally forecast that increases in transmission connected generation would require nine sites to be protected from rising fault level currents. An allowance of £39.5 million was included in RIIO-T1 for this requirement. Due to fewer than expected connections NGET's current assessment is that only one out of the original nine sites needs protection. NGET has already carried out the work required and does not expect to protect the other eight sites in the RIIO-T1 period.

We have decided to reduce the output from nine to one site and reduce allowances by £38.1 million.

NGET originally forecasted a requirement for 11 shunt reactors to manage voltage control and an allowance of £53.3 million was provided. NGET now forecast a higher need for voltage control and is expecting to spend £201 million on building shunt reactors.<sup>3</sup>

We do not dispute NGET's assessment that the need for voltage control is potentially higher now than it was at the time we set the price control.

However, shunt reactors on the transmission network are only one of a range of technical and operational solutions available to manage voltage on the system. We think that increasing the output by the number of shunt reactors required creates a perverse incentive as there may be other more cost-effective solutions for consumers. We think it would not be in consumers' interests to increase the number of shunt reactors required by the output. Instead it is for NGET to decide in conjunction with other stakeholders (e.g. the distribution networks and the system operator) what the most efficient range of solutions is as the needs of the system evolve. We consider NGET is adequately funded for carrying out these activities.

We have decided to make no change to the shunt reactors output and associated funding.

We intend to implement these decisions by modifying the Price Control Financial Models (PCFMs), which form part of the licences, for NGET and NGGT in 2017 so that revenue changes can take effect from 1 April 2018.

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<sup>3</sup> Data based on the 2015-16 regulatory reporting pack submission received on 31 July 2016.

# 1. Purpose and scope of the mid-period review

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1.1. The RIIO-T1 and GD1 price controls were the first to implement our RIIO approach. A key development in the RIIO framework is the lengthening of the price control period from five to eight years. This was to encourage companies to make longer-term plans, allowing greater innovation and efficiency savings to be made that would ultimately benefit consumers.

1.2. Another key part of the RIIO approach is the focus on “outputs”, which are intended to capture the things valued and needed by consumers. We hold the companies to account and take action in cases where they do not deliver.

1.3. Over an eight year price control government legislation or consumers’ or users’ needs could change. We included the Mid-Period Review (MPR) to address these possible changes through a focussed review of output requirements and the associated funding needed.

1.4. When including an MPR, we were very clear that it would not consider issues more broadly in a way that would undermine the aims of moving to an eight-year price control and the consequent benefits. Instead, we said clearly that the MPR would narrowly focus on changes to output requirements. It would not be used as an opportunity to re-open the price control more widely or change any of the key financial parameters (such as the cost of capital). We also said that any changes would be symmetric, i.e. outputs and allowances could go up or down in response to changes in need.

1.5. We published our decision to launch an MPR for RIIO-T1 only (not for GD1), on three specific areas where we considered output requirements may have changed.

- 1) **National Grid Gas Transmission’s (NGGT) Avonmouth pipelines output.** We included an output in RIIO-T1 to help manage safety and security of supply risks following the expected closure of the Avonmouth LNG terminal. We included an allowance of £169.0 million for the delivery of this output.
- 2) **NGET’s new enhanced system operator (SO) outputs.** We introduced new roles in NGET’s licence as part of the Integrated Transmission Planning and Regulation project. We also approved NGET’s application to introduce two balancing products - Supplemental Balancing Reserve and Demand Side Balancing Reserve. No allowance for delivering these new activities was included when the RIIO-T1 price controls were set.

- 3) **National Grid Electricity Transmission's (NGET) outputs to** protect nine sites against rising fault level currents and install 11 shunt reactors. An allowance of £92.8 million is linked to these works.

## Work on other issues

1.6. We have identified a number of important issues that we intend to address through separate processes. We have published a separate consultation paper seeking views on a number of these matters.

## Update on Impact Assessment

1.7. We still consider the Impact Assessment we published alongside our consultation document to be applicable. We have received no comments on the Impact Assessment and have decided to largely retain our minded-to position.

## 2. Gas Transmission

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This chapter sets out our decision on the Avonmouth pipelines output for National Grid Gas Transmission (NGGT).

### NGGT: Avonmouth pipelines

2.1. The RIIO-T1 price control included an output and associated funding to build pipelines in Avonmouth<sup>4</sup> to address safety and security of supply issues. NGGT has since reassessed the need for the pipelines and now considers they are not needed.

2.2. After considering responses to our minded-to position, we have decided to remove the Avonmouth pipelines output and associated funding, as the output is no longer required. This decision will reduce allowances by £168.8 million.

### Background

2.3. The Avonmouth pipelines output was included in our final proposals for RIIO-T1 to address safety and security of supply issues arising from the expected closure of the Avonmouth LNG storage facility.

2.4. The Avonmouth storage facility supported National Grid's gas transportation network by providing Transmission Support Services (TSS)<sup>5</sup> and Operating Margins (OM).<sup>6</sup> In its business plan submission for RIIO-T1, National Grid identified the pipelines as the most efficient means to manage the consequences of the closure of the gas storage facility.

2.5. In our Final Proposals for RIIO-T1 we decided to include the pipelines as an output and included an allowance of £169.0 million.

2.6. NGGT has since carried out a fresh assessment of its options and concluded that the pipelines are not needed. NGGT said that it has spent £0.2 million on work to assess its technical and strategic options.

2.7. We reviewed NGGT's assessment of the need for the pipelines. The change in the needs case is driven by two factors:

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<sup>4</sup> The pipelines output comprises two segments. The Easton Grey to Pucklechurch segment to address the security of supply issue and the Pucklechurch to Ilchester segment to meet safety needs.

<sup>5</sup> Transmission Support Services support the network at times of exceptionally high demand (security of supply).

<sup>6</sup> Operating Margins contribute to safety by helping to maintain system pressure in the event of a loss of supply due to either network failure or damage to the network.



## Mid-period review decision

- 1) NGGT's demand forecasts are lower than at the time we set the price control. This means that the need for Transmission Support Services has reduced to the extent that investment in the Easton Grey to Pucklechurch gas pipeline segment cannot be justified.
- 2) NGGT has re-assessed its safety case since we set the price control and has now concluded that the Pucklechurch to Ilchester pipeline segment is not needed to meet safety requirements. The Health and Safety Executive has not objected to NGGT's assessment.

2.8. We do not dispute NGGT's assessment that the current safety case and security of supply requirements do not support building the new pipelines.

### **Our minded-to position**

2.9. Our minded-to position was to remove the output and reduce allowances by the amount not spent (£168.8 million).

2.10. We set out our expectation that NGGT, as part of its wider functions, would meet its safety and security of supply obligations in the absence of the pipelines.

2.11. We considered two alternative options. First, to delay the financial adjustment to the end of RIIO-T1. We decided against this option as we thought there was sufficient certainty and justification to make the adjustment now.

2.12. We also considered an option put forward by NGGT to remove the output and make a smaller adjustment to allowances. Construction of the pipelines was a multi-year project with the £169 million spread across several years. Of the £169 million allowance approximately £86.6 million was allocated to be incurred prior to 31 March 2017. NGGT argued that the adjustment to allowances should exclude this amount on the grounds that removing the entire allowance constitutes retrospective action of the sort that we said we would not do.

2.13. We disagreed with NGGT. Our commitment not to make retrospective adjustments relates to areas such as underspends from more efficient delivery. In this case the output has not been delivered. We said that removing the output and £168.8 million in allowances is fairer to consumers and is consistent with our past statements.

### **Responses**

2.14. Citizens Advice,<sup>7</sup> British Gas,<sup>8</sup> Storengy<sup>9</sup> and RWE Supply and Trading<sup>10</sup> supported our minded-to position to remove the output and associated allowances.

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<sup>7</sup> Citizens Advice 2016, *Citizens Advice formal response: Consultation on the mid-period*

2.15. British Gas found the Avonmouth pipelines output "...a clear example where work is no longer required and therefore the output and funding allowances should be removed."<sup>11</sup> British Gas considered that National Grid Gas Transmission's proposal to retain a proportion of the pipeline allowance would "...create a regulatory regime where rewards were greater for good luck or over forecasting than for genuine efficiency improvements."<sup>12</sup>

2.16. Storengy stressed that the Operating Margins lost following the closure of the Avonmouth storage facility may still need to be compensated at the national level.<sup>13</sup>

2.17. NGGT disagreed with the minded-to position believing that it "...sends the wrong message to network companies regarding ex ante incentivisation and the promotion of innovation which are the cornerstones of the RIIO regulatory framework."

2.18. NGGT considered that the Avonmouth allowance should not be removed.

2.19. NGGT also said it understands there may be views that the benefit from not adjusting the allowances might be too high, but that zero benefit is not appropriate either. NGGT again suggested that it retain its share of the benefits accrued. NGGT considered that this approach would address its concern about the creation of distortions and undermining of the RIIO principles of promoting innovation. This approach would mean making no change to the £86.6 million in allowances that had been allocated prior to 31 March 2017.

2.20. NGGT also said that we should extend the Transmission Support Services (TSS) incentive scheme. The TSS incentive scheme provides an allowance to procure services used as a substitute for pipeline capacity during periods of high demand, by managing flows and avoiding system constraints. This is done by either contracting gas to be supplied from Avonmouth LNG storage (when it was still operational) or limiting the demand on the network with commercial arrangements with specific network users.

2.21. NGGT considered that extending the TSS will ensure that it is left with the same risk profile as in the final proposals.

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*review of RIIO-T1, p.5*

<sup>8</sup> British Gas 2016, *Response to consultation on the mid-period review (MPR) of RIIO-T1*, October, p.3

<sup>9</sup> Storengy 2016, *Storengy UK answer to Ofgem's MPR for RIIO-T1 Consultation*, p.1

<sup>10</sup> RWE Supply & Trading 2016, *Response: Consultation on the Mid Period Review (MPR) of RIIO-T1*, p.1

<sup>11</sup> British Gas 2016, *Response to consultation on the mid-period review (MPR) of RIIO-T1*, October, p.3

<sup>12</sup> British Gas 2016, *Response to consultation on the mid-period review (MPR) of RIIO-T1*, October, p.3

<sup>13</sup> Storengy 2016, *Storengy UK answer to Ofgem's MPR for RIIO-T1 Consultation*, p.1

## **Our decision**

2.22. After considering the responses, we have decided to maintain our minded-to position. We will remove the Avonmouth pipelines output and reduce allowances by the amount not spent (£168.8 million).

2.23. The RIIO model was designed to set upfront the outputs that network companies are required to deliver and the revenue they are able to earn for delivering these outputs efficiently. The output was specifically set as a pipeline solution. As the output is not required no revenue should follow.

2.24. We also do not agree with NGGT's proposal to extend the TSS incentive scheme for two reasons.

2.25. First, while we recognise that services to provide additional capacity may be required beyond 2018, we consider that the TSS incentive scheme falls out of scope of the MPR, which is limited to the consideration of specific outputs. We consider that a decision to reopen the price control more widely would not be appropriate.

2.26. Second, we consider the possible need for the TSS in the future is driven by falling demand, which drove the reduced need for the Avonmouth pipelines. We consider that the risks and opportunities from falling demand on the TSS rests with NGGT.

2.27. We note that falling demand has enabled NGGT to only spend £30,000 of the £21.7 million allowance provided for the first three years of RIIO-T1. If we were to make changes to the TSS to reflect falling demand we would need to consider lowering these previous allowances provided along with possible requirements beyond 2018.

2.28. In any event, NGGT has not provided any evidence that the requirements for the TSS are likely to be significant in the future. Any costs that NGGT do incur following the conclusion of the TSS scheme in 2018 will be shared with consumers through the total expenditure sharing scheme.

2.29. With regard to Storengy's concerns over operating margins, we expect NGGT to continue to fund these requirements through the gas system operator incentive scheme. If costs are higher than forecast at the time of final proposals, then it is NGGT who bears this risk, with higher costs being shared with consumers through the gas system operator incentive scheme.

## 3. Electricity Transmission

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This chapter outlines our decision to maintain our minded-to position on National Grid Electricity Transmission's (NGET) enhanced system operator (SO) role as well as the fault level and shunt reactor outputs.

### **NGET: Enhanced System Operator role**

3.1. NGET, in its role as system operator, is responsible for operating Great Britain's electricity transmission system and for entering into contracts with those who want to connect to and use the electricity transmission system.

3.2. As part of the MPR we considered the extra System Operator responsibilities taken on by NGET to meet the demands of consumers and electricity transmission network users. We recognised that there are incremental costs associated with delivering these duties that are not included in the allowances for the current price control.<sup>14</sup>

3.3. NGET requested £23.6 million to fund these activities to reflect the additional responsibilities taken on and related costs incurred. We proposed to allow £21.5 million in our August consultation. NGET and other stakeholders largely support this approach.

3.4. We have decided to maintain our minded-to position and add a new output to fund these additional roles.

### **Background**

3.5. NGET requested funding for three activities related to its role as system operator:

- 1) Obligations created under the Integrated Transmission Planning and Regulation (ITPR) project.
- 2) New balancing services: Demand Side Balancing Reserve (DSBR) and Supplemental Balancing Reserve (SBR).
- 3) A Demand Side Response Programme.

3.6. Our ITPR project looked at the arrangements for planning and delivering the onshore, offshore and cross-border electricity transmission networks. This was to

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<sup>14</sup> Ofgem 2016, *Decision on a mid-period review for RIIO-T1 and GD1*, May, para 2.23

ensure the coordinated, economic and efficient development of the electricity system in the long term.

3.7. The ITPR project ran from 2012 and the final conclusions were published in March 2015. Following this, we introduced new obligations for NGET. These obligations came into effect on 2 November 2015.

3.8. These new responsibilities from ITPR primarily relate to system planning and the annual delivery of the Network Options Assessment report. This mechanism requires NGET to assess and report on the need and timing of future reinforcements across Great Britain. It also requires NGET to assess cross-border interconnector capacity requirements.

3.9. NGET introduced SBR and DSBR into the market in 2014/15 as part of its balancing services arrangements. SBR and DSBR are available to NGET for three winters leading up to 2017/18, when the capacity market introduced by the Department for Business, Energy and Industrial Strategy will come into effect. These services provide NGET with additional tools to help balance the system in the event that the market is unable to provide sufficient reserves to do so.

3.10. NGET has also created a new programme aimed at encouraging and facilitating increased participation in Demand Side Response. This includes:

- Raising awareness among industrial and commercial demand customers of market possibilities.
- Organising activities aimed at electricity industry stakeholders to help ensure that sufficient routes to market exist and that there is a level playing field for demand customers who wish to participate.

### **Our minded-to position**

3.11. In June, NGET proposed cost estimates for the System Operator activities set out above. We scrutinised these estimates and reduced allowances where resources or costs were duplicated or not justified. Table 3.1 sets out NGET's request and what we proposed.

3.12. Our minded-to position was to provide additional funding. We wanted to ensure that efficient costs for the System Operator are appropriately funded given the continuing development of new services and the need to ensure the system is effectively managed.

**Table 3.1 Our decision on NGET's enhanced SO activities**

Output area	NGET's funding request (2009/10 prices)	Our decision (2009/10 prices)	Period covered by funding request and allowances
ITPR activities	£16.92m	£15.00m	1 April 2014 to 31 March 2021
SBR/DSBR	£4.56m	£4.50m	1 April 2013 to 31 March 2017
Demand Side Response	£2.10m	£2.02m	1 April 2015 to 31 March 2019
<b>Total</b>	<b>£23.58m</b>	<b>£21.52m</b>	

## Responses

3.13. Scottish Hydro Electric Transmission did not dispute our proposal to provide an allowance for the new activities<sup>15</sup> while SP Transmission agreed further funding should be provided.<sup>16</sup>

3.14. Electricity North West urged that under ITPR the System Operator should be encouraged to take a whole system view and proposed an additional obligation that the choice made is the most efficient and effective. Electricity North West also indicated that it could provide solutions that will aid the system operator.<sup>17</sup>

3.15. Citizens Advice stated that the consultation inadequately demonstrated how we had reached our minded-to decision to allow or disallow particular revenue for NGET. It considered that insufficient details were provided of NGET's funding requests, the business case behind them and the reasons for Ofgem varying the allowance.<sup>18</sup>

3.16. Citizens Advice said it would have been good practice to mention the possibility of adding new balancing services as a new output as part of the initial scoping consultation in November 2015. They also considered that funding for Demand Side Response should not be provided as it is business as usual for the system operator.<sup>19</sup>

<sup>15</sup> Scottish Hydro Electric Transmission 2016, *Response to consultation on the mid-period review (MPR) of RIIO-T1*, p.1

<sup>16</sup> SP Transmission 2016, *Response to consultation on the mid-period review (MPR) of RIIO-T1*, p.2

<sup>17</sup> Electricity North West 2016, *Consultation on the mid-period review (MPR) of RIIO-T1*, p.2

<sup>18</sup> Citizens Advice 2016, *Citizens Advice formal response: Consultation on the mid-period review of RIIO-T1*, p.6

<sup>19</sup> Citizens Advice 2016, *Citizens Advice formal response: Consultation on the mid-period*

3.17. BEAMA, a trade association for the electro-technical industry, said that it supports providing additional funding for Demand Side Response services.<sup>20</sup>

3.18. RWE Supply and Trading supported our proposed treatment of the new enhanced system operator role for NGET.<sup>21</sup>

3.19. NGET's response confirmed the basis of the original request and provided no new evidence in support of its funding request. NGET did however accept our minded-to position to disallow certain costs.

3.20. NGET also accepted the proposal to produce two short reports on the Demand Side Response programme, but requested further clarification on what should be the focus of the report.

### **Our decision**

3.21. Our decision is to maintain our minded-to position and provide a total of £21.5m additional funding for the ITPR, new balancing services and Demand Side Response.

3.22. In regards to the Demand Side Response we require NGET to produce a report which covers:

- 1) all costs incurred;
- 2) the activities undertaken;
- 3) quantitative and qualitative impacts of the programme; and
- 4) anything else NGET considers relevant.

3.23. We would expect this to be an annex to the regulatory reporting pack in July 2017 (covering the period 1 April 2015 to 31 March 2017) and July 2019 (covering the period 1 April 2017 to 31 March 2019).

3.24. We liaised with NGET to provide Citizens Advice access to the material we used to come to our minded-to position. NGET offered to discuss the documents with Citizens Advice.

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*review of RIIO-T1, p.6*

<sup>20</sup> BEAMA 2016, *BEAMA Response to Ofgem Mid Period Review (MPR) RIIO T1*, p.1

<sup>21</sup> RWE Supply and Trading 2016, *Consultation on the Mid Period Review (MPR) of RIIO-T1*, p.1

3.25. Citizens Advice reviewed the material and considered the detail provided to be what it hoped for in a consultation response. We have published this material (with the confidential elements redacted) with this decision.

### **NGET: Fault levels and shunt reactors**

3.26. The RIIO-T1 price control for NGET included outputs to protect nine sites against rising fault levels and install 11 shunt reactors.

3.27. NGET has confirmed that it will only need to protect one site against rising fault levels, due to fewer generator connections. We have decided to adjust this output to reflect that only one site is being protected and reduce allowances by £38.1 million.

3.28. NGET has identified a need for more shunt reactors to be deployed to respond to a higher level of embedded generation than projected in their business plan submission. We are concerned that providing funding on the basis of the number of shunt reactors deployed will provide perverse incentives as cheaper alternative options may be available.

3.29. We have decided to maintain the status quo and make no change to the shunt reactor output. This represents a shift from our minded-to position to declassify the output, following the consideration of stakeholder responses. Retaining the output provides us with another avenue to ensure that NGET delivers in the interest of consumers.

### **Background**

3.30. The RIIO-T1 price control for NGET includes the following two outputs:

- 1) Protecting nine sites against rising fault currents.
- 2) Installing 11 shunt reactors.

3.31. NGET reported that it only needs to protect one site against rising fault levels. This is due to fewer than expected generation connections to the transmission network. NGET has carried out the work required to protect the one site and does not expect to do any further work in RIIO-T1. We provided an allowance of £39.6 million for fault levels.

3.32. On shunt reactors, NGET is now forecasting a higher need for voltage control due to a number of factors, including greater embedded generation than expected. NGET expects to spend £201 million<sup>22</sup> compared to the allowance of £53 million.

### **Our minded-to position**

3.33. We consulted on a minded-to position to:

- 1) Reduce the fault level output to one site needing protection and lower allowances by removing £38.1 million.
- 2) Declassify shunt reactors as an output and make no adjustments to allowances.

3.34. We proposed to declassify the shunt reactor output on the basis that there are a range of technical and operational solutions for managing high voltage issues on the network. We were concerned that specifying shunt reactors as an output, when alternative solutions exist, risks creating a distortion in favour of installing shunt reactors when they are not necessarily the most cost-effective solution for consumers. We also considered that NGET has alternative sources of funding to draw upon if needed to manage voltage on the network.

3.35. We considered the risk of distortion more acute in the case of shunt reactors than fault level protection.

3.36. We considered that changing the fault level output was in the interests of consumers as nearly all of the allowance for the output is not needed.

### **Responses**

3.37. Citizens Advice<sup>23</sup> and RWE Supply and Trading<sup>24</sup> supported our minded-to position on fault levels and shunt reactors.

3.38. British Gas supported our decision to reduce the fault levels output, but was concerned that removing the shunt reactor output could incentivise NGET to seek solutions that are not in consumers' best interests.<sup>25</sup> British Gas suggested retaining

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<sup>22</sup> This number is different to what was included in the August 2016 Consultation as we have received an updated estimate from NGET.

<sup>23</sup> Citizens Advice 2016, Citizens Advice formal response: Consultation on the mid-period review of RIIO-T1, p.7

<sup>24</sup> RWE Supply & Trading 2016, *Response: Consultation on the Mid Period Review (MPR) of RIIO-T1*, p.1

<sup>25</sup> British Gas 2016, *Response to consultation on the mid-period review (MPR) of RIIO-T1*, October, p.3

an output as it places a requirement on NGET to demonstrate how it has addressed the voltage control issues in a way that is in consumers' best interests.<sup>26</sup>

3.39. BEAMA commented that our minded-to position on fault levels was understandable.<sup>27</sup> BEAMA believe that we should reconsider our minded-to position to leave funding unchanged for system voltage control requirements.<sup>28</sup>

3.40. Electricity North West said that it does not "believe that outputs should, as a general approach, be declassified."<sup>29</sup> Electricity North West commented that the removal of obligations and allowances that are already in progress is extremely difficult and raises significant concerns about regulatory risk and the overall cost of finance.

3.41. SP Transmission said it was not clear what the implications will be from declassifying an output and requested further clarification. It said that it is not convinced that the decision to declassify the shunt reactor output is in the long term interests of consumers. SP Transmission suggested that the proposed increase in investment is placed in suspension, pending consideration of available options to manage voltage.<sup>30</sup>

3.42. NGET did not agree with our minded-to position. It considered that we had not justified why different treatment for fault level protection and shunt reactors is appropriate. It said that we appeared to have looked at each output in isolation by removing allowances for the reduced fault level requirements, but not acknowledging the increase in costs of managing voltage. NGET proposed that we declassify both the fault level and shunt reactors outputs and leave the funding arrangements unchanged.

### **Our decision**

3.43. After considering these responses, we have decided to reduce the fault levels output and make no change to the shunt reactors output.

3.44. We consider that retaining the shunt reactors output (as opposed to declassifying) results in a better outcome for consumers as it allows us to continue to hold NGET accountable for delivery. Making no change removes the distortion and incentive for shunt reactors to be installed when other options are available (declassification would also have achieved this outcome).

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<sup>26</sup> British Gas 2016, *Response to consultation on the mid-period review (MPR) of RIIO-T1*, October, p.3

<sup>27</sup> BEAMA 2016, *BEAMA Response to Ofgem Mid Period Review (MPR) RIIO T1*, p.2

<sup>28</sup> BEAMA 2016, *BEAMA Response to Ofgem Mid Period Review (MPR) RIIO T1*, p.2

<sup>29</sup> Electricity North West 2016, *Response to consultation on the mid-period review (MPR) of RIIO-T1*, p.1

<sup>30</sup> SP Transmission 2016, *Response to consultation on the mid-period review (MPR) of RIIO-T1*, pp 3-4

3.45. We believe that this approach addresses the concerns raised by British Gas, Electricity North West and SP Transmission regarding declassification.

3.46. We don't think an alternative approach of increasing the shunt reactors output would be in the interests of consumers. This option would create a perverse incentive to install shunt reactors even if there are other more cost effective solutions. Shunt reactors on the transmission network are only one of a range of technical and operational solutions to manage voltage on the system. It is for NGET to decide in conjunction with other stakeholders (e.g. the distribution networks and the system operator) what the most efficient range of solutions is as the needs of the system evolve.

3.47. We also maintain our position that no further funding for shunt reactors should be provided. We think NGET has sufficient funding to draw upon if needed to engage with other stakeholders and ensure voltage is managed efficiently across the system.

3.48. We do not agree with NGET that we have not justified treating fault levels and shunt reactors differently. As we set out in our consultation, there is a reduced risk of distortion with fault levels relative to shunt reactors.

3.49. We do not consider that it would be in consumers' interests to, as NGET propose, retain funding for the fault levels output as nearly all of the allowance for the output is no longer required.