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Decision for statutory consultation on modifications to the RIIO-ET1 & RIIO-GT1 PCFMs to incorporate the Mid-Period Review

On 22 March 2017, we published a Statutory Consultation¹ on the modifications needed to the RIIO-ET1 and RIIO-GT1 Price Control Financial Models (PCFMs) to implement our Mid-Period Review (MPR) decision.² We proposed to change totex allowances within the PCFM and therefore to have the revenue impact flow through into the MOD_t term for 2018/19.

We received two responses to the consultation: one from National Grid and one from SP Transmission³. Both responses have been published on our website alongside the original consultation.

National Grid agreed that the modifications appropriately incorporated the MPR decision.

SP Transmission agreed with the modifications to maintain the ex-ante reward profile. However, they suggested that instead of our proposed approach for adjusting allowances, we restate prior Base Revenue terms (BR_t) and the adjustment should flow through into Allowed Revenue for 2018/19 via the Correction Factor (K_t).

Having considered this response, we do not think that the alternative methodology is superior to our original proposal. While it would also accomplish broadly the same objective, it would do so in a less transparent way and would be inconsistent with other changes to totex allowances which are all contained in the PCFM. For example, the four volume drivers applicable to National Grid (the IWW, DRI, UCE and GCE variables) may all change prior years totex allowances, but the revenue impact of this is always brought forward into the most recent year via the MOD_t value.

The alternative method would also result in less money being returned to consumers, as revenue impacts are brought forward at the vanilla Weighted Average Cost of Capital (WACC) in the PCFM but at the Bank of England base rate plus, generally, 2% in the Correction Factor. We note however, that this would not always be the case and depends on the movements in the base rate and our cost of debt index.

We have therefore decided to proceed with the modifications as proposed in our consultation.

We note that one of the paragraphs in the consultation document contained a typo. Paragraph 2.21 read 'reduce NGGT's totex allowance for the Avonmouth pipeline by the amount not spent' whereas it should have read 'reduce NGGT's totex allowance for the

¹ <https://www.ofgem.gov.uk/publications-and-updates/mpr-statutory-consultation-modifications-et1-gt1-pcfms>

² <https://www.ofgem.gov.uk/publications-and-updates/mid-period-review-decision>

³ SP Transmission initially submitted a confidential response. They later provided a version for publication on our website.

Avonmouth pipeline to the amount spent'. Given the correct statements throughout the rest of the document, we do not believe this typo had a material impact on the consultation.

Next steps

We originally published provisional PCFMs with the MPR modifications alongside the consultation document. These models have been republished on our RIIO-ET1 PCFM⁴ and RIIO-GT1 PCFM⁵ pages on our website. They will come into effect on 13 July 2017, 56 days after the publication of this decision.

It is not yet confirmed that these will be the final PCFMs for use in the Annual Iteration Process (AIP) 2017. We may need to make further adjustments for a number of ongoing work streams. The final models will be confirmed in October.

If you have any questions on this letter, please contact matthew.brown@ofgem.gov.uk.

Ian Rowson



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Associate Partner, RIIO Finance
Duly authorised on behalf of the Gas and Electricity Markets Authority
17 May 2017

⁴ <https://www.ofgem.gov.uk/network-regulation-riio-model/price-controls-financial-model-pcfm/riio-t1-financial-model-electric>

⁵ <https://www.ofgem.gov.uk/network-regulation-riio-model/price-controls-financial-model-pcfm/riio-t1-financial-model-gas>