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Dear James

RIIO-T1 Mid Period Review decision and consultation on Mid Period Review 'Parallel work'

Thank you for the opportunity to respond to your consultation on RIIO-GD1 and RIIO-T1 Mid Period Review 'parallel work'.

As a Distribution Network Operator we are not familiar with all of the detail of the mechanisms included in the consultation. Instead, we focus our response on the potential principles and precedents involved in this consultation as they may relate to the RIIO-ED1 price control.

It is important to note that the RIIO-ED1 control is different in some key respects to the RIIO-T1 and RIIO-GD1 controls. While we would expect many similar principles to be applied across all controls, some aspects should be implemented differently for RIIO-ED1. In particular, we note that

- the scope of the Mid Period Review for RIIO-ED1 is defined in a tighter to way to that of the earlier price controls:

- the incorporation of specific Close Out mechanisms, in combination with more clearly articulated Network Output Measures, means that many of the decisions considered to be part of Mid Period Review for RIIO-T1 licensees will instead be considered as part of RIIO-ED1 Close Out for DNOs; and

- the specific rules around Business Plan Commitments for RIIO-ED1 mean that some of the decisions made here for GDNs and TOs would not be appropriate for DNOs.

Principles that we agree with and should be replicated for RIIO-ED1 Mid Period Review

We agree that where licensees will be required to deliver new outputs as a consequence of changes in obligations or the interpretation of those obligations then the efficient cost of delivering these should be funded via allowance increases.

We agree that delivery of outputs via different solutions is to be encouraged. To promote innovation, it is essential that licensees are confident that they will retain the sharing factor on any savings that are delivered through finding different solutions to deliver outcomes for customers. Customers will continue to benefit from this lower cost of delivery in future price controls.

We agree that licensees should continue to share any recovery of compensation from contractors for late delivery of projects with customers. Without this sharing of recoveries received licensees would have no incentive to recover the costs and customers would ultimately pay more.

Principles that we disagree with and are inappropriate for all sectors

We are concerned at the suggestion that networks could be held to account for the wider consequences of delays to projects in a way that was not envisaged at the price control or in the licence. The construction of price controls has generally constrained the risks to which licensees are exposed to defined penalties for factors such as supply interruptions and customer satisfaction. To expose network companies to the risk of unexpected adjustments for the wider costs of network unavailability increases risk in a way that is not consistent with the low cost of capital earned by companies.

Similarly, we disagree with the suggestion that redress payments might be due to customers for non-delivery of commitments that are not afforded output status in the licence under certain circumstances. We take the commitments that we made to our customers in our well justified business plan very seriously. However, it is also important to remember that these were stretching targets associated with a proposed plan and built within a particular set of assumptions. For DNOs, this was acknowledged in the wording of the Business Plan Commitment reporting licence condition. The changes that have occurred since plans were proposed, both exogenous changes to the environment in which licensees operate as well as changes to the funding ultimately proposed by Ofgem may mean that it is no longer appropriate for all targets to be met. Changing the formal status of measures mid price control is poor process and increases regulatory uncertainty. We also note that proposing to make payments for non-delivery of safety-related commitments might expose licensees to 'double jeopardy' with HSE decisions relating to the same measures.

The only circumstances under which we would expect payments to be required to be made to customers in a way that is not envisaged in the specific price control arrangements would be if the licensee is found to have failed to discharge its general duties, such as the duty to develop and maintain an efficient, co-ordinated and economical system of electricity distribution.

We are surprised that Ofgem feels it needs to make allowance adjustments to reflect spend profile changes within a price control. The effect of Ofgem's Annual Iteration Process is to 'true- up' the difference in expenditure in a way that is NPV-neutral at WACC. The only circumstances under which we think such an adjustment would justified would be if the cashflow effect of the difference in spend profile meant that licensees would face unacceptable financial ratio deterioration in the later years of the price control as a consequence of the slippage.

Issues that should be addressed differently for RIIO-ED1

We agree that customers should not fund outputs that are no longer required. However, we do not agree that adjustments for these changes should be made as part of the Mid Period Review. For RIIO-ED1, we would expect such allowance adjustments to take place via either High Value Project reopeners/ Close Out or, for smaller projects, via NASDs Close Out. In the circumstances where the project is no longer required we expect that these would be treated as Justified Under-Delivery of outputs and not be subject to further penalty.

We note that Ofgem is making the allowance changes via a PCFM modification without also making formal changes to the output targets for the price control. Whilst this may be an appropriate modification route for TOs, any amendment to outputs for DNOs would need to be accompanied by formal changes to agreed outputs, for example by amending the Network Assets Workbook.

We agree that adjustments to allowances should be made to reflect outputs that have not been delivered. We also agree that adjustments should be made to reflect additional justified outputs that have been delivered but which were not funded at the price control decision. However, for RIIO-ED1, we would expect these adjustments to be made at Close Out for those activities that are within scope of Network Asset Secondary Deliverables or a defined reopener (unless material differences in expenditure are known at reopener windows).

Many of these mechanisms will rely on the existence of detailed RIIO-ED1 Close Out methodologies. It is essential that the work to further develop detailed Close Out mechanisms is completed as soon as possible.

If you have any questions regarding our response please do not hesitate to contact me.

Yours sincerely

Sarah Walls

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Sarah Walls
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