



# T1 and GD1 mid-period review parallel work

*Response to Ofgem's consultation dated 24 February 2017*

## KEY POINTS

- **The Authority will be aware that it must exercise caution in adjusting price controls it has already implemented, outside the mechanisms provided for in those controls, to avoid the risk of damaging investor confidence and raising long-term costs for consumers.**
- **In this light, the proposed positions on most of the items covered by the consultation appear well judged.** In particular:
  - **Output accountability:** Ofgem is right to focus on the highest level of output possible, where there is ambiguity in the price control, since this will encourage companies to choose the most efficient option that meets the needs of end users.
  - **National Grid Gas Transmission Compressors:** the proposal to focus on the output purpose seems appropriate; to do otherwise would be damaging for efficiency incentives.
  - **Scottish Power Transmission's voltage control:** the proposed approach, focussing on the end user requirement for voltage control (rather than specifics about which power station is closing) seems appropriate, since it avoids micro-management.
  - **London medium pressure mains:** the price control decision does not appear to include a claw-back mechanism and therefore it would seem appropriate for Ofgem to accept NNGD's offer, as proposed.
  - **Other gas distribution 'outputs':** these 'outputs' were set as carrying a reputational incentive and therefore it seems entirely appropriate to continue this approach.
- **However, with the Western HVDC link it is not clear that the threshold for re-opening a price control settlement is met and there is a risk of inconsistency between different Authority decisions. The Authority should consider this item carefully.**
  - One reason stated for re-opening is to remove a perverse incentive. Yet it is not clear how strong the perverse incentive is, nor is this alone considered a strong enough reason to adjust Scottish Power Transmission's connections volume driver.
  - The other reason is to better protect consumers, but this should not be assessed narrowly or with the benefit of hindsight – all the potential costs should be considered.
  - The Authority should consider respecting the price control settlement, and focus instead on the licence and price control provisions that it has at its disposal; it can still take any financing benefit into account when assessing the size of a penalty, if one is warranted.
- On terminology, we would welcome guidance on how the Authority intends to use RIIO 'outputs' terminology in future as there seems to have been drift away from the terms set out in the RIIO handbook, creating scope for confusion. It may be an appropriate time to align more closely with the water sector terminology, with 'outcomes' supported by 'outputs' specified at various levels (broad through to specific assets).

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## 1. Overview

- 1) This short paper sets out Northern Powergrid's response to the questions in Ofgem's *Consultation on mid-period review parallel work*, dated 24 February 2017 (the consultation).
- 2) We have organised the paper as follows.
  - a. We respond to the initial question on scope in this overview section;
  - b. We respond to the questions on output accountability in section 2;
  - c. We respond to the questions on price control adjustments in section 3;
  - d. We provide a brief comment on terminology in section 4.

### ***Scope: Do you agree with the scope of the MPR parallel work***

- 3) In general we believe that the scope of this type of work – to potentially adjust price controls after they have been implemented outside the mechanisms provided in those controls – should be limited as tightly as possible to limit potential damage to investor confidence and higher associated financing costs to consumers over the long-term.
- 4) In terms of the exact items already included in the review by Ofgem, the adjustment to the categories the items are arranged under does not cause any obvious issues.

## 2. Responses to Ofgem's questions on output accountability

***General approach, Question 1: Do you think we are right to focus on output purpose where there is ambiguity to decide when an output is delivered? If not, please explain and provide evidence.***

- 5) Yes, Ofgem is right to focus on the purpose of the requirement where there is ambiguity over how to measure whether and when it is delivered. This will encourage companies to choose the most efficient option that meets the needs of end users.
- 6) Overly prescriptive specification of the requirements would remove flexibility for companies to respond to new developments and would raise costs overall, to the long-term detriment of consumers. By focussing on the purpose of the requirement, where possible, Ofgem will promote the long-term interests of consumers.

7) Ofgem's proposal is therefore aligned with the principles set out in the RIIO handbook. It represents an application of an existing RIIO policy, rather than a new policy.<sup>1</sup> Ofgem is just specifying the secondary deliverables in the least restrictive way possible, which was always the intent under RIIO.

*General approach, Question 2: What do you think about our alternative options including focussing on the detailed output specification or output declassification? Will they achieve our purpose? Can you think of any other alternatives?*

8) The first of these alternatives – focussing on the detailed output specification – would disregard the RIIO guidance (referred to in our response above) and represent a change in policy. Removing flexibility from companies about how to deliver particular requirements would raise costs over the long-term and so is not in the interests of current or future consumers.

9) The second of these alternatives – output declassification – may represent a re-opening of the price control and in general that should be avoided, although it is possible that occasionally declassification may be appropriate (e.g. if the output served no purpose because no mechanisms had been attached to it, or because it did not provide reputational information).

*NGGT gas compressors: Do you agree with our proposed approach to hold NGGT to account if it complies with the IED requirements? If not, please explain why and provide evidence.*

10) Yes, we agree. The proposed approach is fully aligned with the principles in the RIIO handbook and therefore is appropriate.

*SPT voltage control: Do you agree with our approach to consider the output delivered if SPT manages voltage across its network efficiently? If not, please explain why and provide evidence.*

11) Yes, we agree. The proposed approach is fully aligned with the principles in the RIIO handbook and therefore is appropriate.

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<sup>1</sup> Ofgem, 2009, RIIO Handbook, page 43, Table 4: guidance on the inclusion of secondary deliverables, point 2. Note that the outputs referred to in the question are by definition 'secondary deliverables' under the original RIIO terminology.

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### 3. Responses to Ofgem's questions on price control adjustments

***Western HCDC Question 1: Do you agree with our proposed approach to delay allowances due to the delivery of the Western HVDC? If not, please explain why and provide evidence.***

12) Ofgem's proposal appears to be to re-open the price control settlement specifically for what it thinks may be a missing element in relation to the Western HVDC.

13) One reason stated for re-opening is to remove a perverse incentive. Yet it is not clear how strong the perverse incentive is, nor is this alone considered a strong enough reason to adjust Scottish Power Transmission's connections volume driver. The consultation does not state figures on the value at stake, making it difficult to form an informed view on the strength of the incentive.

14) The other stated reason is to better protect consumers, but this should not be assessed narrowly or with the benefit of hindsight – all the potential costs should be considered. By re-opening the price control, Ofgem risks undermining investor confidence. The damage this may do is enhanced in a context where Ofgem chooses not to re-open settlements for errors or missing elements (one example is the choice not to adjust the Scottish Power Transmission revenue driver, even though this mechanism appears to be badly specified). Damage to investor confidence will carry longer term costs to consumers in the form of higher financing costs. A narrow assessment of the steps that will best protect consumers will miss this fact.

15) The Authority should consider respecting the price control settlement, and focus instead on the licence and price control provisions that it has at its disposal; namely its enforcement tools. Provided these tools are used properly, it is not clear that there is any missing element of the price control.

***Western HVDC Question 2: Do you have any views on how we should delay allowances? Please explain and provide evidence.***

16) As we do not agree that it is appropriate to re-open the price control on this issue we do not have any views on the exact mechanism.

17) However, we do note that if Ofgem were to use other tools at its disposal, it could take into account any financing benefit in the size of any penalty (should one be justified).

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**Western HVDC Question 3:** *Do you have any view on how we should treat payments and in-kind benefits from suppliers paid to compensate for the delay? Please explain and provide evidence.*

18) As we do not agree that it is appropriate to re-open the price control on this issue we do not have any views on the exact mechanism.

19) However, we do note that if Ofgem were to use other tools at its disposal, it could take into account any compensation received by the relevant companies in the size of any penalty (should one be justified).

**NGGD medium pressure main:** *Do you agree that we should accept National Grid Gas Distribution's (NGGD) proposal to return £53.9 million? If not, please explain why and provide evidence.*

20) Given National Grid Gas has proposed to return the £53.9m, and in the absence of a formal mechanism in the price control that would allow more money to be returned (e.g. the currently forecasted cost of meeting the secondary deliverable), it seems to be appropriate to accept NGGD's proposal.

**NTS exit capacity incentive:** *Do you agree that we should not make changes to the NTS exit capacity incentive? If not, please explain why and provide evidence.*

21) We generally agree that it is better not to revisit price control decisions that have already been implemented, outside the mechanisms provided for in those controls.

22) If any of the issues raised by British Gas have merit, but there is no readily available route for adjusting the mechanism within the current price control, then it would be appropriate to take them into account at the RIIO-GD2 review.

**Safety repair risk:** *Do you agree with our proposed approach to continue to monitor this output for the remainder of RIIO-GD1 and require companies to justify where they fail to meet this output? If not, please explain why and provide evidence.*

23) We generally agree that it is better not to revisit price control decisions that have already been implemented, outside the mechanisms provided for in those controls.

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**Reliability loss of supply:** *Do you agree that we should change the targets for the loss of supply output for the remainder of RIIO-GD1, continue to monitor performance and require companies to justify where they fail to meet this output? If not, please explain why and provide evidence.*

24) We generally believe that it is better not to revisit price control decisions that have already been implemented, outside the mechanisms provided for in those controls. It is however possible to see distinctions in this case that could justify a revision.

25) The relevant companies could have asked the Competition and Markets Authority for leave to appeal against the licence targets when the licence modification was made. However, the targets were explicitly set for assessment later, with no automatic revenue adjustment mechanism as part of the GD1 licence conditions. This may mean that the right to appeal will instead accrue at a later date, as and when a licence modification is made to impose penalties (e.g. following the next price control review). If this is the case, then it would seem appropriate for Ofgem to take the opportunity now to correct its errors. And, having reached this view, the value from making the correction will be maximised if it is made sooner rather than later, so that the companies concerned can be monitored against the 'correct' targets.

**Maintaining operational performance:** *Do you agree with our proposed approach to make no changes to this output for the remainder of RIIO-GD1, to continue monitoring this output and to require companies to justify where they fail to meet this output? If not, please explain why and provide evidence.*

26) We generally agree that it is better not to revisit price control decisions that have already been implemented, outside the mechanisms provided for in those controls.

**SPT's trigger mechanism:** *Do you agree with our proposed approach to this trigger mechanism? If not, please explain why and provide evidence.*

27) We generally agree that it is better not to revisit price control decisions that have already been implemented, outside the mechanisms provided for in those controls.

28) Based on the content in the consultation document, it seems reasonable to consider that the relevant refurbishments will not be funded if the conditions for activating the trigger mechanism are not met. It therefore seems appropriate that any funding mechanism which applies to 'unfunded' investments would apply to the relevant refurbishments.

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## 4. Other issues not consulted on

*A comment on terminology: we would welcome clarity on the 'output' terminology Ofgem wishes to use in future*

29) We would welcome guidance on how the Authority intends to use RIIO 'outputs' terminology in future as there seems to have been drift away from the terms set out in the RIIO handbook, creating scope for confusion. For example:

- a. In the overview to the consultation, Ofgem proposes to 'focus on consumer outcomes rather than the output detail', yet under the RIIO terminology, consumer outcomes are outputs.
- b. In the main consultation, the term 'output' is frequently applied to requirements that would more aptly be described under RIIO as 'secondary deliverables'. The term secondary deliverable is used in only one sub-section, on maintaining operational performance.
- c. This may in turn reflect the fact that, in the RIIO-GD1 Final proposals, the term 'primary output' was applied to many items that looked more like secondary deliverables.

30) The terminology drift may be confusing to stakeholders, particularly those that work across RIIO sectors, or wider network sectors such as water (where 'outcomes' are synonymous with 'RIIO primary outputs', while 'outputs' are synonymous with 'RIIO secondary deliverables'). The mismatch between Ofgem and Ofwat's terminology, in particular, creates scope for cross-sector confusion; this scope for confusion is enhanced when Ofgem moves between its own terminology and that used in the water sector.

31) It may be an appropriate time to align more closely with the water sector terminology, with 'outcomes' supported by 'outputs' specified at various levels (broad through to specific assets). Alternatively Ofgem could re-confirm its RIIO terminology (primary outputs supported by secondary deliverables – perhaps abbreviated to outputs and deliverables).

32) We do not have a particular preference and will readily adopt whichever convention Ofgem chooses.