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Dear David,

RIIO-2 methodology for the Electricity System Operator: Decision and further consultation

This response is from National Grid Electricity Transmission plc (NGET) and solely relates to question 12 in the consultation: whether it would be more efficient if transmission network owners bear Transmission Network Use of Service (TNUoS) revenue collection risk. The narrow scope of our response should not be taken as agreement with other concepts in the consultation which link to the broader RIIO-2 framework such as cost of capital. We point Ofgem to our response to the RIIO-2 Sector Specific Methodology Consultation for our views and evidence on the proposed RIIO-2 framework. This response is not confidential.

NGET agrees there is benefit in considering where the TNUoS revenue collection risk should best lie and would welcome discussion with Ofgem and other network owners. This should be a considered discussion given the materiality of the risk currently with the Electricity System Operator (ESO). Any assessment should use the RIIO principle of risk lying with the party or parties best able to manage the risk and critically needs to ensure that wherever the risk is managed, there is adequate recompense for the party.

Over the last five years, there have been significant variations between allowed and collected revenues, with under-recoveries peaking at over £100m per annum. We understand that the existence of this risk is requiring the ESO to procure a working capital facility to manage the cashflow risk. This working capital facility will be a cost to the ESO which is directly linked to the revenue recovery risk and will require funding through the price control. Whilst the nature of the network owners' balance sheet means the need for a working capital facility may be reduced by transferring the risk, this does illustrate that managing the risk involves cost which needs funding. This is a fact that may have been hidden when the ESO was part of NGET.

Any assessment of where the risk will need to recognise and address some practical details and potential consequential additional risks:

- Any transfer of the revenue shortfall risk to transmission owners would remove the direct financial exposure of the ESO to forecasting and tariff calculation errors which generally the ESO is in the best position to manage. Given this, it is important for transmission owners to have assurance that accurate forecasting and tariff calculations would remain a priority for the ESO, for example by implementing suitable performance incentives.

- Any transfer of the revenue shortfall risk to transmission owners should be consistent across all transmission owners (or reflect that one owner is taking risk on behalf of others). The simplest, most non-discriminatory approach would be to allocate revenue collection shortfall pro-rata with each transmission owners' proportion of total revenue (be they from onshore TOs, OFTOs, future CATOs, and interconnectors seeking top up to an allowed floor revenue). However, the nature of the licences and contracts of the TOs may give rise to implications of such an allocation which would need to be assessed.

I hope this response is helpful. Please contact me if any clarification is required and we look forward to discussing the matter.

Yours faithfully,

Chris Bennett

Director, UK Regulation

[By email]