RIIO-2 Draft Determination Consultation Response

Core Document

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Core Document – Consultation Response

1 Embedding the consumer voice in RIIO-2

Q1 What role should Groups play during the price control period and what type of output should Groups be asked to deliver? Who should be the recipients of these outputs (companies, Ofgem and/or stakeholders)?

The business specific Customer Engagement Groups have played a valuable role in ensuring that business planning has been reflective and responsive to the needs of customers and broader stakeholders. We support the continuation of these groups throughout RIIO2 and specifically see a role for them in challenge companies' ongoing performance, proposals under uncertainty mechanisms and RIIO3 business planning.

We have set out our views on the enduring role that the Customer Engagement Group during RIIO2 in Section 3.4.2 of our Business Plan and our views remain the same. In summary, we propose that the role of the Group should be to challenge the business on our performance against the promises set out in our plan and our responsiveness to changing consumer needs. We have proposed that the CEG delivers an annual Independent Assessment of their findings, and that this be published publicly and available to all.

Q2 What role should Groups take with respect to scrutinising new investment proposals which are developed through the uncertainty mechanisms?

We believe that the Groups can play a valuable role in scrutinising new investment proposals developed through the uncertainty mechanisms. Specifically, the Groups could provide independent challenge as to whether proposals are based on a robust understanding of stakeholder (including customer) needs, have the support of stakeholders and clearly represent value for stakeholders. This role would be consistent with the role the Groups have played in the business planning process and, indeed, should play in the planning process for RIIO3. Mirroring this process, CEGs could provide independent assessments of company proposals to Ofgem as part of the process for reopeners. For this to be a meaningful addition to the process, Ofgem would need to clarify how they would take the view of CEGs into account within decision making.

Q3 What value would there be in asking Groups to publish a customer-centric annual report, reviewing the performance of the company on their business plan commitments?

Within our Engagement Strategy for RIIO2 (Section 3.4.2 of our Business Plan) we have set out proposals for an annual, independent report, published by the Customer Engagement Group, assessing our performance against the promises set out in our plan and our responsiveness to changing consumer needs. The Independent Assessment will improve transparency of the businesses' performance; clearly communicating to stakeholders, including Ofgem, where stakeholders' needs are being met, the degree to which the company is adapting to meeting changing needs as well as where further focus, action or improvement is required.

Q4 What value would there be in providing for continuity of Groups (albeit with refresh to membership as necessary) in light of Ofgem commencing preparations for RIIO-3 by 2023?

The Customer Engagement Groups (CEGs) have played an important role in Business Planning during RIIO2 and we have identified the numerous areas in which their challenge has led to better outcomes for customers and broader stakeholders in our Business Plan (Section 3.2.1). Company specific challenge groups, in the form of CEGs, allowed for detailed and intensive challenge of individual plans, as well as on the ground assessment of the stakeholder engagement process, throughout the business planning process.

The CEG members have invested large amounts of time in understanding the detail of regional customer preferences and the challenges facing individual businesses and the wider industry. This knowledge and experience cannot be easily replaced or replicated. We would support the continuation of the CEGs role in scrutinising company's business planning for RIIO3. The consistency and continuity of these groups will allow us to build towards the RIIO3 process and not have start again and rebuild that knowledge and experience.

However, for the full value of their role (to stakeholders) to be delivered further clarification is needed on Ofgem would take into account the CEG's conclusions in its own decision making.

2 Quality of Service -setting outputs for RIIO-2

Q5 Will the combination of the two proposed Licence Obligations support the delivery of a digitalised energy system and maximise the value of data to consumers?

The combination of the two proposed Licence Conditions will certainly contribute towards the delivery of a digitised energy system and maximum benefit for customers. However, full value will only be realised if the LO's are embraced for what they truly are, an opportunity for cross sector (and beyond) collaboration and innovation, and an opportunity for Network Companies, Suppliers, OFGEM, BEIS and anyone else to work together towards a common goal.

NGN are in full and total support of this approach.

Q6 Do you agree with our proposed frequency for publication of updates to the digitalisation strategy and the digitalisation action plan, respectively?

We completely agree with the frequency of publication of the living Digitalisation Strategy and Action Plan. We will be publishing these not just to OFGEM but making them publicly available. We would also welcome regular collaborative discussions with OFGEM, not just a six-monthly formal review, so that we can continue to work together to move in the right direction.

Q7 What kinds of data do you think should comply with the data best practice guidance to maximise benefits to consumers through better use of data?

Any piece of data could hold the key to valuable insight, and it would be short-sighted to set limits on what data would be useful. However, this does not presuppose a Free-For-All, laissez-faire approach to data or data management. There needs to be comprehensive governance around the use of data, based on the data best practice guidelines, and this governance must be agreed and consistently applied by all parties. A consistent triage process is required for all data requests and transfers. Common ontology will minimise issues around the understanding or misunderstanding of data sets. Particular attention must be given to personal data and personally identifiable information, not only to maintain compliance with GDPR but because it is the right thing to do.

Collaboration between all parties (energy sector companies, regulators, government, etc) is essential to make this happen, and NGN will be working with all stakeholders with the aim that our sector becomes an exemplar of great data management, governance and insight.

Q8 Do you agree that the Groups could have an enduring role to work with the companies to monitor progress and ensure they deliver the commitments in their engagement strategies?

Yes. Our reasons for believing that the Customer Engagement Groups will bring value in this role is set out in Section 3.4.2 of our Business Plan

Q9 Do you agree with our proposal to accept the proposals for an ODI-R for BCF and the other proposals set out above as EAP commitments and to require progress on them to be reported as part of the AER?

Yes, we agree with Ofgem’s proposal.

3 Ensuring efficient cost of service

Q10 Do you agree with our proposed RPEs allowances? Please specifically consider our proposed cost structures, assessment of materiality, and choice of indices in your answer.

Ofgem have used an industry average to determine the proposed cost structure to apply RPEs at a notional GDN level. This cost structure is broadly in line with our own and the approach is consistent with other areas of analysis, and so we agree with it. The assessment of materiality has identified the same cost areas for RPE as we did in our own analysis, and so again we support that.

In terms of the RPEs themselves and as importantly the weightings used to allocate them across the various cost areas, we believe further work is needed. The GDNs and Ofgem identified that a future Cost Assessment Working Group should be used to review this. In terms of the weightings and indices:

- Its proposed that four indices are used for Labour, with equal 25% weightings. Our biggest concern is the weightings, 25% for instance is based on ONS AWE transport and storage, this weighting is much too high relative to the actual amount of labour carrying out this activity. In response to an SQ the GDNs all provided a breakdown of their labour resource which can be used to provide a better weighting;
- We suggest that AWE data which links more closely to this labour resource breakdown would be a better proxy for cost trends for labour. The AWE categories we considered are Professional, scientific and technical (PST), Administrative and support services (ASS), and electricity, gas and water supply (EGWS)
- Again, four indices are proposed for materials with equal 25% weightings and similarly the weightings are not correct. Plastic pipe receives the same 25% weighting as copper piping, when we spend 10 times more on PE than copper piping;
- In terms of indices our materials contracts are linked to various indices, including PIEWEB, LEBA, ICIS and Oanda. As such these are a better fit for NGN and
- We would support Ofgem raising an SQ for all GDNs to provide a breakdown of their materials costs into agreed materials types, and the indices if any they use within their contracts to set prices. This would enable an industry level assessment to take place.

Q11 Do you agree with our proposed ongoing efficiency challenge and its scope?

Our submitted costs included an ongoing efficiency challenge of 0.5% p.a. across Totex, reflecting the significant business changes we have made in RIIO-1 and our position as the most efficient GDN, as well as the latest Band of England and Office for Budget Responsibility forecasts. As such we agree that GDNs should be expected to deliver ongoing efficiency.

However, we have serious concerns about Ofgem's proposed ongoing efficiency challenge, which is significantly higher at 1.2% p.a. for Capex and Repex, and 1.4% for Opex p.a. Cumulatively this means we would have to make an extra £30m of savings to break even. The process Ofgem and Cepa have used to derive these assumptions has material flaws. These are outlined in our attached report, 'Frontier Productivity Growth; a report prepared for the ENA' which has been prepared by Frontier Economics, and include:

- Ofgem failed to recognise the clear and incontrovertible evidence that there has been a demonstrable step change in productivity growth since the global financial crisis, which affects GDNs through supply chains and contractors;
- Ofgem assert there is a rising trend in longer term productivity growth, but this is only when compared to the near zero rate seen since 2010, with no expectation that growth will return to historic levels;
- No impact has been assumed for COVID-19. Both the OBR and Bank of England state that productivity will be weighed down during the 'containment' phase of the pandemic, and expect there will be medium term 'scarring' on the rate from decisions taken now;
- The CEPA analysis and Ofgem application assumes that the higher Value-Added productivity measure can be applied to all of Totex, which is not the case. As a result, the outturn productivity growth assumptions are too high;
- The time period considered in the CEPA report covers three distinct periods – pre, during, and post the financial crisis – which obscures what is really happening now and over the last 10 years, which is clearly more relevant;
- The business sectors chosen for comparison are too wide and should be narrowed down to appropriate 'comparators'; and
- The 0.2% addition for Innovation funding, which seems poorly calibrated as even the major examples CEPA quote deliver better outcomes for customers, not efficiency savings. Also, the rational for installing the funding was not to make GDNs 'super innovators' but to plug a historic gap and ensure we kept pace with wider productivity.

There are a number of issues that Ofgem and its consultants have chosen to exclude from its assessment and analysis. The analysis assumes that the productivity potential is equal across all companies in the sector and takes no account of economies of scale or scope. Smaller companies such as NGN face greater challenges in delivering productivity improvements than companies of much greater size. Sustainable productivity improvements, such as those postulated by Ofgem and its consultants, invariably come from investment in new technologies and processes. The returns available for larger companies with shared resources is far greater than for smaller companies and hence represents a significant economy of scale. An effect that has been incorrectly ignored in the analysis that considers companies to largely be homogenous in their potential for productivity improvements. Ofgem's assessment of efficiency explicitly recognises this scale effect and adjust accordingly.

The analysis only considers productivity as an input measure only. It does not take into account the significant changes in output and the quality of service being provided by companies in the sector. In many instances these service improvements have been provided in business plans at no additional cost and hence in its own rights represents a significant improvement in productivity that has been conveniently ignored in the analysis.

The analysis also ignores the impact of Covid-19 on both the potential for productivity improvements in the wider economy and in particular in the utilities industry. There will be lasting impacts on productivity going forward as a result of amended working practices and policies to manage this new and ongoing risk.

4 Ensuring efficient financing

Please refer to Finance annex question responses.

5 Managing Uncertainty

Q12 Do you agree with our proposed common approach for re-openers?

We support the reopener window moving to January in order to allow further time for assessment and iteration prior to the Annual Iteration Process in November. We do not see the logic for reducing the window to one week from one month. We are only looking to make one submission per window per activity area, so see no need to tighten this further which may put undue burden on the submission and effect its quality.

We do not agree that Ofgem can reject any re-opener that does not contain all the information necessary for them to make an informed decision. We would expect there to be a reasonable period for Subsequent Questions to be raised to clarify points and ask for further information if required. It is not possible for the GDN to have perfect foresight of what Ofgem expect.

We do not agree that the Authority could trigger a reopener at any time; the same logic on frequency of the events and materiality applies both ways. We also believe the Authority should be required to seek guidance from the GDNs on the length of time they will need to prepare a robust response, noting that Ofgem say there will be a minimum of 28 days. In certain circumstances it may take considerably longer, due to the availability of both data and resource.

In terms of materiality we do not believe the materiality threshold should be set at 1% of annual average base revenues for individual reopeners, and 3% for when aggregated (with each reopener passing 0.5%), after the TIM incentive rate has been applied. For NGN this means that each reopener would need to exceed c£8m, and the aggregated reopeners would need to exceed £24m, all in the same year. It is also not clear how the aggregation process works (is it cumulative over RIIO-2, which it should be) or specific to events in that window only? We do not agree that if an item passes the individual test it isn't part of the aggregation process; the cumulative effect of re-openers can be very significant and so all should be considered together against the threshold.

In any case the threshold is simply too high and may have unintended consequences, in particular when most of the other price control parameters have become much harsher in RIIO-2, and more areas of expenditure have been moved into Uncertainty Mechanisms. Having such a high level is a potential blocker for future investment, and could have material cash flow implications for GDNs under the proposed financial package.

Q13 Do you agree with our proposals on a materiality threshold, a financial incentive, a 'foreseeable' criterion, and who should trigger and make the application?

We agree that there should be no materiality threshold or financial incentives attached to the CAM. We also agree that a ‘foreseeable criterion’ requirement is not necessary as there has already been enough scrutiny already enough scrutiny during the Business Plan process.

We agree that a Single licensee should make the application, with a Statement of Agreement from the second party. We do believe Ofgem need to introduce the same licence condition on Electricity now to avoid a two-year gap, as it can be assumed, they are the second party.

Q14 Do you consider that two application windows, or annual application windows, are more appropriate, and should these be in January or May?

We believe annual windows are appropriate as any application may involve a time sensitive project with potential long lead times, and it would be inappropriate for the regulatory process to add unneeded delays. We support the re-opener window being consistent with the other re-openers and moving to January. We do not agree that delaying until May, after financial year end for some Networks, is necessary or appropriate.

Q15 Do you consider that the RIIO-1 electricity distribution licences should be amended to include the CAM, or wait until in 2023 at the start of their next price control?

Yes. No reason to delay.

Q16 Do you agree with our proposed re-opener windows for cyber resilience OT and IT, and our proposal to require all licensees to provide an updated Cyber Resilience OT and IT Plan at the beginning of RIIO-2?

We agree that an updated Cyber Resilience OT and IT plan should be provided at the beginning of RIIO-1 in April 2021. However, this will show limited changes from the plan we have already submitted. Therefore, we support having a further two reopener windows in RIIO-2 – in January 2022 as by then we will most likely have material revisions from our current plans, and then in 2024 with further revisions.

We agree that there should be no materiality threshold given the critical nature of this work, and as such it is outside of the aggregation process for reopeners.

Q17 What are your views on including the delivery of outputs such as: CAF outcome improvement; risk reduction; and cyber maturity improvement, along with projects-specific outputs?

These appear to be appropriate areas to be part of our plans and to consider when assessing projects against the Use it or Lose it allowance mechanism. However, we will need to agree more detail as part of licence drafting so it is clear what is expected and whether it is relevant for assessment. We are already concerned that the IT assessment for Draft Determinations was carried out on some criteria which were not shared earlier and so could not be challenged and reviewed.

Q18 Do you agree with our proposal for the Non-operational IT and Telecoms capex re-opener?

We agree that an updated IT and Telecoms plan should be provided at the beginning of RIIO-1 in April 2021. However, this will show limited changes from the plan we have already submitted. Therefore, we support having a further two reopener windows in RIIO-2; in January 2022 as by then we will most likely have material revisions from our current plans, and then in 2024 with further revisions. This matches our proposals for Cyber Security under Q16

We agree that there should be no materiality threshold given the critical nature of this work and the expected level of change that may be needed as we move to be a digitalised industry, and as such it is outside of the aggregation process for reopeners.

Q19 Do you agree with our approach to using a re-opener mechanism for changes to government physical security policy?

No further NGN sites (apart from the existing site being upgraded in RIIO -GD1) currently fall into the government's classification of Critical National Infrastructure. If there is a change in government Policy during RIIO-2 and further sites were included in this classification NGN would require funding to implement the required upgrades. We consider that reopener mechanism is appropriate to enable access to this funding should it be required.

Q20 Do you agree with our approach regarding legislation, policy and standards?

NGN acknowledges that unfunded changes were required during RIIO1, including changes to the Gas Day required to comply with EU code changes, which incurred significant additional cost. We agree with the specific re-openers for areas of potential change which have been included in the RIIO2 framework address current known potential areas. Additional unknown areas of policy change could result in gas transporters incurring unfunded costs to deliver them within the period. Changes that require significant UNC change also results in additional code administration costs which would benefit from being on a pass-through basis to ensure that the gas transporters are not subject to uncontrollable costs associated with making these changes. This would support further governance reform changes consistent with the BEIS/Ofgem Code Governance Review as well as changes required to deliver improvements to settlement and moving industry arrangements towards a lower carbon future.

6 Net Zero and innovation

Q21 Do you agree with our overall approach to meeting Net Zero at lowest cost to consumers? Specifically, do you agree with our approach to fund known and justified Net Zero investment needs in the baseline, and to use uncertainty mechanisms to provide funding in-period for Net Zero investment when the need becomes clearer?

In principle, for larger uncertain capex projects, we agree with the approach Ofgem has taken in its Draft Decision to manage the affordability of energy bills through the Net Zero transition by deferring provisions for uncertain expenditure until requirements are clearer. We also welcome the opportunity that these uncertainty mechanisms provide for us to receive in-period funding for relevant investments.

However, there is a need for Ofgem to consider the expectations of stakeholders relating to the role networks can play to support decarbonisation efforts.

Our engagement has shown that stakeholders are supportive of networks adopting an ambitious approach to decarbonisation. Specifically, they are supportive of networks delivering business as usual 'plus' investments, despite these investments incurring additional costs.[1]

Energy affordability, particularly given Covid-19, needs to remain a key priority for Ofgem however stakeholders have made it clear that when it comes to net zero, this isn't just a question relating to cost – Ofgem also needs to consider the social value delivered by network activities and act as an enabler of net zero investments, rather than an inhibitor.

For example, it is well known and proven that replacement expenditure of mains and services has both a significant contribution to reducing carbon emissions now, in addition to readying the network for hydrogen. We consider Ofgem has justified many of its decisions on cost reduction rather than the potential for networks to deliver enhanced value for customers and stakeholders.

In RIIO-2, where possible, we intend to meet the expectations of our stakeholders by bringing forward projects for consideration through the uncertainty mechanisms

[1] Northern Gas Networks, *Business Plan 2021-2026*, page 100.

proposed. However, we encourage Ofgem to continue to consider stakeholder views on the importance of networks being able to support decarbonisation efforts as we transition to Net Zero.

We also ask Ofgem to be flexible in its approach and provide a clear framework on how the Net Zero and Heat Policy Reopeners will be triggered, assessed and delivered. This framework needs to be implemented in a practical way that is supportive of early investments. We have provided specific recommendations relating to both reopeners in our responses to the Core and GD Sector documents.

Q22 Do you think the package of cross sector and sector-specific UMs provides the appropriate balance to ensure there is sufficient flexibility and coverage to facilitate the potential need for additional Net Zero funding during RIIO-2?

We consider the package of uncertainty mechanisms is comprehensive, however there are opportunities for Ofgem to provide greater flexibility to ensure the regulatory framework enables (rather than inhibits) project progression. Networks are well positioned to "value add" to low carbon projects and the regulatory framework should enable them to deliver this value to their customers and communities and adapt to changes in the market or government policy as needed.

In our response to Ofgem's consultation on the Net Zero Reopener, we emphasised the importance of ensuring a flexible, principles-based approach to designing and implementing uncertainty mechanisms relating to net zero.

The suite of mechanisms proposed by Ofgem in its Draft Decision (including the Network Innovation Allowance, Strategic Innovation Fund and reopener mechanisms):

- Provide gas distribution networks with funding to deliver the necessary evidence base to government regarding potential conversion of gas networks over to hydrogen (including delivery of trials) and
- Provide gas distribution networks with a mechanism to respond to, following policy or regulatory decisions relating to blending of hydrogen into gas networks and the future of heat (i.e. longer-term conversion to 100% hydrogen).

However, there is limited scope provided in these mechanisms for networks to support initial, small-scale project investments required to establish a hydrogen market and supply chain in the UK.

We understand Ofgem's position that the priority for gas distribution networks is on delivering the evidence base needed to inform a government policy decision on heat; however we encourage Ofgem to consider how it can adopt a more flexible approach to the Net Zero Reopener so that networks can more effectively (and innovatively) support project development. Specific recommendations for Ofgem are outlined in response to Question 23 below.

We also note the importance of the proposed Whole Systems CAM and encourage Ofgem to implement this mechanism prior to the start of ED2, to accelerate project development between gas and electricity networks. We think it's important that this mechanism evolves over time and is supportive of early efforts to develop and deliver collaborative projects.

Q23 Do you have any views on our proposed approach to a Net Zero re-opener?

Following on from our response to Question 22, we consider there are four key opportunities for Ofgem to adopt a more flexible approach to the operation of the Net Zero Reopener:

- *Materiality threshold* A materiality threshold of 1% of annual average base revenues is significant and is an increase on the 0.5% materiality threshold widely adopted in RIIO-1, particularly given Ofgem intends to apply the TIM incentive rate to the costs being assessed. We consider Ofgem should retain the standard threshold of 0.5% currently applied in RIIO-1, and increase its focus on the potential benefits delivered by projects (rather than focusing narrowly on costs) in order to ensure the regulatory framework for RIIO-2 is supportive of investments in net zero, rather than imposing a greater threshold that acts as an additional barrier. Note that we also consider a materiality threshold of 0.5% should apply to the Heat Policy Reopener;
- *Known and justified expenditure* We ask Ofgem to adopt a flexible approach to assessing how "known and justified" costs are, with potential for Ofgem to provide in principle support ahead of a final decision so as not to delay project progression. That said, we also consider it's important that network businesses only bring forward projects if they are confident that the proposed benefits will be delivered. We support the introduction an ex-post review of funding approved through the Net Zero Reopener. Importantly, we consider that a reduction in the materiality threshold along with scrutiny over benefits delivered should effectively manage the administrative burden placed on Ofgem relating to management of the Net Zero Reopener;
- *Responsibility for triggering reopener* – Ofgem has proposed it will have sole responsibility for triggering the Net Zero Reopener but encourages networks to bring forward relevant issues for consideration. We consider networks will be well placed to inform Ofgem as and when relevant circumstances change, so encourage Ofgem to seriously consider the issues raised by businesses throughout RIIO-2 to ensure project development and investment decisions aren't unnecessarily delayed and
- *Reopener triggers* Triggers of the Net Zero Reopener should include key milestones that pre-empt changes in policy. For example, successful delivery of key innovation projects (such as H21 or HyDeploy) should provide justification to trigger the reopener, to enable businesses to bring forward investment opportunities (that will deliver consumer benefit) ahead of a policy decision. This will ensure a cost-effective transition to net zero, so that additional costs are not unnecessarily passed on to consumers while the industry waits for a formalised

policy decision. We also ask that Ofgem considers regional and local authority objectives as triggers for the Net Zero Reopener.

We also consider that proposals brought forward under the Net Zero Reopener should clearly demonstrate their contribution toward relevant net zero targets and consist of a balanced expenditure profile in order to spread investment and risk between current and future gas customers.

Q23 Do you agree with our proposals for the RIIO-2 Strategic Innovation Fund?

In broad terms - Yes.

But given the proposed expansion in the number of parties required to be involved in producing and evaluating the bids we have concerns this process will be overly bureaucratic and slow. The launch of challenges will no longer be annual; however the determination process will be broadly similar. There will need be flexibility within this process to allow for proposals to be addressed based on the value and complexity of the submission. The scope will be set and defined per challenge, as will the eligibility requirements which may create complexity and negatively impact pace.

We also recommend that Ofgem introduces a “fast track” process for projects identified for delivery through the Hydrogen Programme Development Group (HPDG), of which Ofgem is a member. The HPDG has worked collaboratively across its members (including Ofgem, BEIS, HSE and GDNs) to develop an agreed programme of work to deliver the hydrogen evidence base to government to inform its policy decision on heat.

We consider that the SIF is an appropriate funding mechanism for some of the projects identified, particularly through the Integrated Hydrogen Trials and System Transformation sub-groups. Given this, we ask Ofgem to take into consideration the rigorous process that has already been applied through the HPDG to determine the requirement for these projects, to ensure an efficient and fit-for-purpose funding stream for networks to accelerate project delivery. Ofgem should ensure that SIF allocations are available for rapid release to projects that have been pre-determined through the HPDG.

Instead of focusing efforts on assessing the need for these projects, we recommend Ofgem focuses its assessment on project costs, efficiency and whether it’s warranted to pass project costs through to network customers. Adopting this “fast tracked” approach will ensure that Ofgem supports acceleration of projects that have already been identified as required by government.

Q25 Do you have any comments on the additional issues that we seek to consider over the coming year ahead of introducing the Strategic Innovation Fund?

We have no comments.

Q26 Do you agree with our approach to benchmarking RIIO-2 NIA requests against RIIO-1 NIA funding?

There is certainly merit in comparing how companies' GD1 allowances have been utilised compared to their GD2 requests. It would appear some companies have received NIA funding in GD1 and then only partially used that funding, with an increase in utilisation in year eight of GD1. Ofgem should be clear in granting GD2 NIA funding that it understands why this funding has not been used and therefore the credibility of the GD2 requests by such companies.

Q27 Do you agree with our proposal that all companies' NIA funding should be conditional on the introduction of an improved reporting framework?

We have no objection to this proposal. However, the new GD2 NIA funding is severely restricted in scope compared to the GD1 NIA i.e. to vulnerability and energy system transition. Therefore, the new reporting should focus on these areas alone.

Q28 What are your thoughts on our proposals to strengthen the RIIO-2 NIA framework?

In broad terms, we think for the value of projects under the NIA these are overkill and will therefore add delays and costs for no significant value.

Q29 Do you have any additional suggestions for quality assurance measures that could be introduced to ensure the robustness of RIIO-2 NIA projects?

No. The more bureaucracy that is added the greater the barriers that will be put in place of genuine innovation.

Q30 Do you agree with our proposals to allow network companies and the ESO to carry over any unspent NIA funds from the final year of RIIO-1 into the first year of RIIO-2?

This is a good practical proposal which we fully support.

Q31 Do you agree with our proposal that all work relating to data as part of innovation projects funded via the NIA and SIF will be expected to follow Data Best Practice?

Yes. Although the impact on any third-party project partners data would have to be considered.

7 Increasing Competition

Q32 Do you agree with our proposed position on late competition?

We have no comments.

Q33 Do you agree with our proposed approach on early competition?

We have no comments.

8 Approach to the Totex and Business Plan Incentive mechanisms

Q34 Do you agree with our view that SHET, SPT, SGN and WWU passed all of the Minimum Requirements, and as such are considered to have passed Stage 1 of the BPI?

Yes.

Q35 Do you agree with our rationale for why NGET and NGGT should be considered to have failed Stage 1 of the BPI?

Not able to comment.

Q36 Do you agree with our rationale for why Cadent and NGN are considered to have passed Stage 1 of the BPI?

We are strongly in agreement with the view that NGN have passed Stage 1 of the BPI assessment. However, we very strongly disagree with the assessment that our original Business Plan did not meet the criteria with respect to Smart Meter Rollout costs.

Our assessment of Smart Meter volumes, unit costs, total costs and proposal for treatment within the regulatory framework were detailed at numerous points throughout our submission including; Page 104 of the main Business Plan, Page six of Appendix A15, Uncertainty & Risk, Business Plan Data Tables, and our RIIO2 Data Table Commentary.

Based on the data and information available at the time, NGN proposed a smart meter reopener as we believed the cost impact was uncertain and timing difficult to forecast as smart metering roll out plans have constantly changed. The rate of installation seen to date is also not consistent in all areas either which means GDNs have seen different impacts and are likely to see different impacts in the future.

On the issue of the treatment of Smart Metering costs, in the Uncertainty and Risk Appendix to our business plan we set out a detailed assessment of the potential impact of smart metering installation activity on our costs. This was estimated at £1.25m a year when volumes increased and prevented us mitigating any cost increase through down time. This was based on an assumed unit rate of £160 per intervention and the profiled workload we expected to see over the RIIO-2 period, which we expected to increase by between 70-100% from the rates seen earlier in RIIO-1.

NGN proposed that the most appropriate way to deal with this potential impact was via a smart meter reopener. The overall cost impact could be viewed as uncertain due to the difficulties experienced during RIIO1 of forecasting the timing and size of smart meter work. Our experience in RIIO-GD1 has shown smart metering roll out plans have constantly changed. The rate of installation seen to date is also not consistent in all areas either which means GDNs have seen different impacts and are likely to see different impacts in the future.

Our engagement with stakeholders in preparing our Business Plan demonstrated that they supported the principle of Uncertainty mechanisms to address certain issues. That is where there is strong evidence that there will be an impact upon the business in the future but the scale of that impact is uncertain due to lack of upfront clarity on volumes and/or unit costs then a mechanism that allows that issue to be addressed when there is further certainty was supported. At the time of submitting our Business Plan, future Smart Metering costs clearly met these criteria.

The combined dataset and information now available to Ofgem at a national level has provided a significant level of clarity to the extent that certain GDNs have been awarded an up-front allowance to manage the impact on those networks. We have updated our analysis with our latest forecast of installations, using the same unit rates and Ofgem's assumed intervention rate of 2.5% set out in Draft Determination and set out this detail in response to GDQ52. Given this additional information and clarity from Ofgem, we do not believe a smart meter re-opener is needed assuming the above is accepted, any variances from this forecast will be managed through the Totex incentive mechanism, which seems appropriate given the materiality of the costs.

Q37 Do you agree with our overall approach regarding treatment of CVP proposals?

The concept of the CVP was a very late addition to the RIIO2 regulatory framework and such came with only very high-level guidance for companies on the relevant criteria. To a large extent our interpretation of Ofgem's assessment of the submitted CVPs reflected this lack of detail and has led to what we believe to be a range of arbitrary and inconsistent decisions.

As it stands, we cannot support the view that Ofgem's approach acts as any sort of incentive for companies to push the frontier in terms of performance and the associated costs and in doing so take on additional risk which will remain uncompensated. The framework clearly imposes a set of significant risks for companies with no real opportunity. These include:

- A risk that the Ofgem's assessment can and will include a huge range of unspecified and highly subjective criteria which are biased towards rejecting a CVP;
- The proposal will be accepted by Ofgem and included in the framework but with no additional Totex funding to deliver (CVP minimum criteria); and
- The proposal will involve the company takin on risk to deliver that remains unrewarded via any incentive payment.

There are several clear examples where Ofgem's subjective assessment of NGN's proposed CVP should be reconsidered.

a. Restoration of Gas to Appliance within 2 hours

NGN proposed a service offering to ensure the supply to customers appliances is completed within two hours of restoring gas to the ECV following a supply interruption and identified a value of £2.6m over RIIO2 for this service.

Ofgem have rejected this proposal as not being innovative and therefore should not receive a CVP reward. This is seemingly on the basis that this in the context of an Appointment and that three network companies have submitted similar ideas and Ofgem are proposing to apply a common ODI-R for time-bound appointments.

Ofgem have incorrectly linked this proposal to the issue of appointments. NGN's proposal is NOT in any way linked to agreeing an appointment with customers.

Our customer research shows that customers don't consider gas to be restored until appliances are working. The current GSoP in this area focusses solely on restoration of gas to the ECV. The restoration of supply to the appliance is not covered by any standard and will be completed based on the availability of resource.

Our proposal sets out a firm commitment to a significant improvement to within two hours and is financially incentivised. NGN proposed that this would be delivered at no additional/marginal costs. We do not consider other companies have proposed this.

b. Tree Planting

NGN proposed a voluntary tree planting programme of 40,000 trees across our network, delivering £0.95m benefit over RIIO-GD2 and £23m over 50 years.

Ofgem have rejected our proposal on the basis that it constitutes CSR activities that are not within NGN's business footprint, that CSR should be BAU for GDNs and that Cadent also delivered a similar performance in RIIO-GD1, planting four trees for every one cut down.

We would challenge this position on a number of grounds:

- this goes beyond normal CSR as we are proactively investing to improve Biodiversity and air quality in areas where our operations have impact but we have little influence on resolving;

- Disagree that this is beyond NGN footprint as we operate a broad network and engage with communities and customer in many facets. Ofgem have taken a very narrow view of our business footprint;
- Biodiversity improvements on our sites are BAU, as outlined in our EAP and Environment Strategy but mitigating wider business impact is important to customers. Trees planted in urban areas;
- Cadent's claim is not comparable in terms of scale or scope. Our proposal is an additional 40,000 trees delivered through a validated partner. Comparable Cadent performance would be planting 160,000 trees in addition to 4 for every 1 that is cut down and
- We also note acceptance of CVP for Biodiversity CVP for NGGT, NGET and SHET which under a consistent approach from Ofgem should be classed as BAU but has in our view correctly been awarded a CVP as it is a Societal Net Gain. It is clear that our proposal is a net biodiversity gain.

c. Faster Reinstatement

NGN proposed to improve the timescales for reinstatement of a consumer's premises (private land) within three calendar days for planned and unplanned interruptions, delivering £6m benefit over RIIO-GD2.

Ofgem rejected this proposal on grounds of being a Licence Obligation.

This position taken by Ofgem is incorrect. We would remind Ofgem that GSoPs are set as an absolute minimum standard. They are not intended to represent a target and do not preclude more stretching performance targets where this delivers customer value.

d. Hardship Fund & Community Partnering Fund

NGN propose to establish a Hardship fund to support those that cannot afford repairs/replacement to gas appliances post disconnection in RIIO-GD2, delivering £14m benefit over RIIO-GD2 and £49m over 15 years. Additionally, NGN proposed Contribution of £50,000 to a pot which is accessible to community groups and charities, delivering £0.5m benefit over RIIO-GD2.

Ofgem have rejected these proposals on the basis that it constitutes corporate social responsibility (CSR) activities that are not within NGN's business footprint and the view that CSR should be business as usual for GDNs.

However, the fact that Ofgem have accepted these proposals as bespoke outputs indicates that these activities are within NGN's footprint. Ofgem also state that NGN's proposals are supported by stakeholders and are likely to have clear benefits to consumers who need support but have been unable to access it via other routes. In our opinion that this contradicts the reason for rejection by Ofgem Rejected as CVP on basis of CSR.

We also note acceptance of NGGT's proposal to contribute -0.3% of major project spend to community initiatives which is classed as beyond BAU. On this basis, we consider Ofgem have taken an inconsistent approach to their assessment.

e. Agreed Appointments for restoring Gas to the Appliance

NGN proposed the provision of an appointments system for purge and relight activities, if customer is not available during the two-hour time period following restoration to the ECV. This was estimated to deliver £25m benefit over RIIO-GD2.

Ofgem rejected the proposal for CVP due to it not being innovative. However, given three network companies submitted similar ideas, Ofgem have chosen to adopt this as a new common ODI-R for time-bound appointments.

Ofgem have in their assessment consistently but incorrectly linked this proposal with the timebound target for restoration to the customer appliance. Appointments only apply if customer not available within two hours and provides flexibility and service improvement for customers. Our customers have set out that this would provide certainty of when gas is restored and be of significant value.

f. Enhanced Gas Repairs

Ofgem accepted this proposal and that it warranted a CVP reward. However, the CVP value submitted by NGN was revised downwards.

We are pleased that Ofgem saw the value in our proposal. However, we are concerned by reduction of reward given conservative approach taken to assess benefits. We also note that all our proposals were based on 2018/19 discounted costs in line with Ofgem CBA methodology. Whilst we consider our analysis is robust and the reward submitted should stand, any reward given should be on an undiscounted basis to ensure consistency between networks and because the reward is assessed and given at close out of RIIO 2. We would also welcome clarification that rewards will be adjusted for inflation and real carbon price changes in line with wider costs. This ensures that the value at the time of reward reflective of the effort required to deliver the improved service and outcomes throughout GD2, net of any cost pressures outside of networks' control.

Q38 Do you agree with our proposed clawback mechanism to treat received CVP rewards?

Ofgem's proposed claw back mechanism for the treatment of any CVP reward appears reasonable; however, given the penal nature of the CVP assessment process and reduction of rewards it would be appropriate for Ofgem to consider increasing rewards ex-post where a company has efficiently delivered improvements beyond the targets that have been set.

In its draft determination Ofgem rewarded NGN for its CVP proposal for faster gas escapes. Consistent with paragraph 10.74 and 10.75 of the core document NGN has proposed performance metrics for how performance will be measured in RIIO-2. These metrics are covered in greater detail in our response to the NGN Annex questions.

9 Interlinkages in RIIO-2, post appeals review and pre-action correspondence

Q39 Do you have any views on the interlinkages explained throughout this chapter?

The interlinkages set out in the document are explained is a summary and very 'basic' in nature and would be relatively self-evident even without this chapter.

Going forward Ofgem have chosen to give them a significantly greater role in the day to day decision making of companies than at any time in the past or any other regulator in the UK. Given the ongoing nature of these regulatory interventions it is imperative that a detailed assessment of the multiple interlinkages is carried out at each of those intervention decision points that are now part of the regulatory framework.

Of greater concern is the meaningful interlinkages at an operational level that have been 'missed' throughout the Draft Determination proposals between key decisions that have been made by Ofgem. There are significant interlinkages that have not been identified that impact Ofgem's own broader obligations, the companies' obligations, customer requirements and preferences and impacts on other parts of the business. These omissions reflect in many instances the lack of understanding of many of the fundamentals of the businesses that are being regulated and must be improved if Ofgem are to satisfactorily service the more interventionist regulatory role it has given itself going forward.

Q40 Are there other interlinkages within our RIIO-2 package that you think are relevant to the three pillars identified in this chapter?

The details of where we believe interlinkages have been missed our incorrectly reflected within the proposals are set out in detail in the response to the relevant sections of this paper.

Q41 Do you have any views on our proposal to include a statement of policy in Final Determinations that in appropriate circumstances, we will carry out a post appeals review and potentially revisit wider aspects of RIIO-2 in the event of a successful appeal to the CMA that had material knock on consequences for the price control settlement?

We have serious concerns with the nature of this proposal, which is both broad and ambiguous, and potentially undercuts the whole basis of the appeals process. The parties to an appeal, and the CMA themselves, have full scope to consider all the interlinkages as a part of any appeal. The CMA can take into account all the interlinked parts of a price control when reaching its determination on any of the parts that have been appealed. If appropriate, the CMA can rule on those interlinkages or refer those back for Ofgem to consider.

It is incumbent upon Ofgem, as the sector specific regulator with all the necessary expertise and resources, to identify any aspects of the price control that it considers to be interlinked. By the point of any appeal Ofgem will have finalised numerous decisions on different aspects of the price control, and as a part of that decision-making process it will have identified and considered any interlinkages. It will, therefore, be a relatively straight forward process for Ofgem, as the sectors' regulatory expert, to bring to the attention of the CMA any detailed regulatory and operational interlinkages that have not been brought to the attention of the CMA by any appealing party.

The RIIO-ED1 appeals established that it is possible to appeal individual elements of a price control and does not require an 'in the round' assessment by the CMA of an entire price control. A price control is a construct consisting of a large number of individual decisions which, unless interlinked, can be reviewed individually by the CMA. The unilateral post appeal proposed in the Draft Determination suggests a desire by Ofgem to reverse previous decisions on the appeal process and return to an "in the round assessment" when aspects of an appeal are upheld against it.

Q42 Do you have any views on the proposed pre-action correspondence, including on the proposed timing for sending such to Ofgem?

We find this proposition somewhat bizarre in that we are being requested to present a case for appeal before a decision capable of being appealed has been made. In addition, there will have been extensive correspondence with Ofgem throughout the price control process which will clearly indicate those areas of the price control that are in dispute between the Ofgem and the network companies. Should any company bring up a new issue at the CMA appeal stage, that has been capable of being brought to the attention of Ofgem during the price control process, this would undoubtedly count against it during the CMA's consideration.

Our past experience of price control final determinations by Ofgem is that new policy decisions and new analysis can change the nature of the settlement at this very late stage. It can take a number of weeks for the underlying data to be made available and fully reviewed. We have previously identified material errors which have sometimes been corrected, and on other occasions they have not as part of an "in the round decision". We would, as we have done in the past, seek to bring any errors in Final Determination to Ofgem's attention but we would not be in a position to set out in full any pre-appeal issues in the proposed timescales.

10 Impact of COVID-19 on the price controls

Q43 Do you think we need specific mechanisms in RIIO-2 to manage the potential longer-term impacts of COVID-19? If yes, what might these mechanisms be?

It is clear that Covid-19 and the UK's response to manage the spread of the virus has had a significant impact during 2020 on the network companies' operations. This has been in terms of the ability to deliver a number of key requirements and the costs of delivering those services. This impact has been recognised via the 'regulatory easements' put in place by Ofgem during 2020. At this time the Covid-19 is still a 'live' issue and continuing to impact upon operations. Restrictive Covid-Secure working practices are still in place to manage the spread of the virus with companies having to respond to the evolving landscape that includes short-term, local and regional lockdowns. The full extent of the impact upon network companies' operations in 2020 is therefore still unknown and hence attempting to identify a mechanism to deal with an issue that is still yet to be fully defined would not be appropriate.

However, it is clear that the impact of Covid-19 will continue to have a significant impact upon network companies' operations beyond 2020 and well into the RIIO-GD2 period and potentially beyond, for example, mandated Tier 1 Mains Replacement. In many areas Covid-19 has meant that RIIO-GD1 commitments have not been able to be delivered in full and a 'catch-up' will be required in future years. The impacts upon companies will not have been totally consistent for many reasons including the different responses across the UK and the different positions of companies in their delivery programme when lockdown was imposed.

Our view is that existing level of uncertainty along with the complexity and heterogenous nature of the impact across regions and companies will require a broad reopener mechanism during RIIO-GD2 that has the flexibility to deal with these very specific impacts. Care will need to be taken to ensure that the mechanism is not restrictive in its scope or timings such that it does not inhibit the companies abilities to deliver on its statutory duties.

we are
the network