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National Grid response to Ofgem's RIIO-2 Statutory Licence Consultation:

Executive Summary



National Grid Response to Ofgem's RIIO-2 Statutory Licence Drafting Consultation

Executive Summary

Introduction

This is the executive summary to the response from National Grid Electricity Transmission plc (NGET) and National Grid Gas plc (NGGT) to Ofgem's RIIO-2 Statutory Licence Consultation published on 17 December 2020.

We have engaged fully in Ofgem's licence drafting working groups since September 2019 and have provided extensive drafting comments throughout that process and also in response to the informal licence drafting consultation published in September 2020. In our response to that consultation we also highlighted that there were a significant number of areas where material issues remained unclear, unresolved or were still under development and we outlined proposed remedies in respect of each. Many of these issues have not been addressed.

The licence drafting accompanying the statutory consultation contains a significant number of errors and drafting issues that must be corrected. On our understanding that Ofgem still intends to direct the licence modifications on 3 February 2021 we would urge Ofgem to make all of these corrections prior to that direction given their importance to the licence drafting appropriately giving effect to the Final Determinations. In the event that this should not be possible, given that Ofgem will have only two weeks to address and correct these errors, we request that Ofgem gives consideration to having a longer period of time to review this response to enable all of these errors to be corrected. To allow for this, Ofgem should consider delaying the licence directions that will implement the RIIO-2 licence modifications for NGET and NGGT until after 3 February 2021. We are aware of the issues that such a delay would present but there is precedent for such an approach (the implementation of the TPCR4 adapted rollover which had retrospective effect) and we would be willing to discuss how this can be achieved with Ofgem over the next few days.

There are two important points that we wish to highlight in this executive summary:

1. The errors identified in the licence and Price Control Financial Instruments; and
2. The lack of clarity emerging from the licence drafting and Associated Documents that impacts on our ability to assess the licence framework as a whole.

We expand on these points below. As ever, our legal, finance and policy specialists stand ready to work with Ofgem to resolve these outstanding issues ahead of the statutory licence modification directions.

1. The errors identified in the licence and Price Control Financial Instruments

The licence drafting accompanying the statutory consultation contains a significant number of errors and drafting issues that must be corrected. These errors cover a broad range of issues from simple cross referencing, typographical and defined terms errors to more material matters such as inappropriately defined PCD outputs, incorrect allowances, defective value derivation formulae and incorrect PCFM inputs that have a material impact on revenues.

We have provided extensive drafting comments on a condition by condition basis for each of the NGET and NGGT licences and for the Price Control Financial Instruments in the Annexes to this response. Where relevant, the Annexes also set out where we seek further clarification from Ofgem in relation to particular drafting. We do not believe that correcting the identified issues will be controversial as these matters relate to the incorrect or imprecise implementation of the policies and decisions that are set out in the Final Determinations on which Ofgem has already consulted. We therefore request that Ofgem takes sufficient

time both to correct these errors and also provide the required clarification prior to the licence modification directions.

We include a total of 13 Annexes with this response. These consist of the following in respect of each of NGET and NGGT:

- Annex in respect of Chapters 1-9 of the Special Conditions;
- Annex in respect of Special Conditions being removed;
- Annex in respect of standard (NGET) / standard special (NGGT) conditions being modified;
- Annex in respect of the PCFH; and
- Annex in respect of the PCFM;

Together with three Confidential Annexes in respect of Cyber Resilience IT and OT PCD Tables.

2. The lack of clarity emerging from the licence drafting and Associated Documents that impacts on our ability to assess the licence framework as a whole

Incomplete PCFM model, lack of visibility of the PCFM guidance and uncertainty in relation to the Allowed Revenue re-publication process

The PCFM has yet to be developed in its entirety. Particular issues relate to the lack of Regulatory Financial Performance Reporting which informs the Return Adjustment in the licence and the Tax Reconciliation template which requires networks to identify and categorise differences between the regulatory tax allowances and corporation tax liability attributable to the licensee. This omission is of particular concern as the reconciliation forms the basis of a Board Assurance Statement and is the trigger for Ofgem to instigate a tax review and potential reopener direction.

Also of concern is the lack of visibility of the PCFM Guidance document which is extensively referenced throughout the PCFH and which we infer will include detail on how the forecasting framework is applied to the variable value inputs in the PCFM. Whilst we advocate Ofgem's introduction of a forecasting approach in principle, we are unable to fully support its enactment (and assess the likely impact on our customers through the impact on revenue volatility) without the complete set of relevant guidance documents.

Similarly, Ofgem has introduced a re-publication process through the statutory consultation which enables Allowed Revenue to be updated in line with the charge setting timetable. We support this concept in principle, as it has the potential to limit volatility of revenues and charges across the price control period, but we are unable to confirm that the process will operate correctly in practice as intended due to the limited detail provided. In addition, the licence drafting does not reflect the principles set out in the reasons and effect document accompanying the statutory consultation.

We request that Ofgem provides all outstanding documentation as soon as practicable and we are committed to working with Ofgem to bring clarity and governance to these areas of the framework.

Ofgem should provide clarity to ensure that the T1 Close Out does not result in significant revenue and charging volatility

Our stakeholders have made clear to us that predictability and stability of revenues are important to them. The close out of the RIIO-1 period has the potential to result in material revenue adjustments which could produce significant revenue and charging volatility across the RIIO-2 period if adjustments are not made across several years. We have previously proposed to Ofgem that the current RIIO-1 process of using a specific legacy revenue term to phase any such adjustment over the RIIO-2 period will limit this volatility. However, under the current consultation proposals there is no such mechanism and there is no clarity in respect of the framework that will apply to reflect revenue adjustments arising from the close out process.

We request confirmation from Ofgem that a specific term will be included to address this issue or that it will clarify how this can be achieved under the framework as currently drafted.

Material Obligations in Associated Documents

Many of the proposed Associated Documents are, in effect, additional licence obligations placed in a document outside of the licence that is capable of being amended by Ofgem with no associated right of appeal by licensees to the CMA. Material obligations on licensees should be set out on the face of the licence, rather than in Associated Documents, in line with best regulatory practice. Associated Documents should be limited to procedural steps or to levels of detail which it would not be appropriate to cover in the licence condition for some clear reason. We again request that Ofgem commits to follow these principles in the development of Associated Documents or otherwise commits to revisit the modification process for these documents to allow for self-modification by the Authority only where the licensee considers that the proposed modification to the Associated Document is not likely to have a significant impact on the licensee's obligations. In any case, it must be clear what obligations are imposed on licensees and in particular Ofgem should not allow obligations to be placed in Associated Documents which are not drafted with sufficient precision to ensure this.

In addition to the above, material issues relating to the operation of the PCD mechanism (e.g. what is meant by "Not Delivered" and the financial consequences of such events) should be set out on the face of the licence. Setting out the financial consequences of an Evaluative PCD assessment in an Associated Document does not provide licensees and other stakeholders with the required certainty and clarity of outcome for the price control period.

Self-modification of the licence conditions for "minor" changes

The proposals include a new proposed "housekeeping" condition which, if implemented in its current form, will allow Ofgem to make "minor" changes to the licence by direction. The definition of such changes contains a list of changes which are unlikely to prove contentious. However, this is not set out as an exhaustive list to provide clarity on the remit of the condition – that it is intended for non-substantive changes to the licence. We raised our concerns on this in response to the informal licence consultation but have been given no further clarification. We still consider that the statutory process could be used adequately to implement any of the housekeeping changes. However, given Ofgem has not given further explanation of its policy intention following the concerns raised, our understanding is that (in line with accepted legal principles) "minor changes" in the condition is to be interpreted in line with the list which follows it and is therefore limited to changes which are non-substantive. Substantive changes could not be made through this process. In particular, we note that this process could not be used to correct errors raised in this response where the correction leads to a substantive change to the licence. This is consistent with the references made by Ofgem to "administrative changes^{1[66]}" in the consultation document. We request that Ofgem changes the drafting to make the list exhaustive and that, if this is not done, Ofgem confirms that our understanding set out above

Lack of clarity as to obligations that will be placed on licensees by the Data Best Practice Guidance

To date we have not been provided with a copy of Ofgem's proposed "Data Best Practice Guidance". Given that the new Digitalisation licence condition requires us to use "best endeavours" to comply with such Guidance when "working with or making decisions about the use of Energy System Data", this is concerning to us. As the licence contains only a high level and broad description of the intended scope of that document, we are neither able to understand the obligations that we will be subject to nor assess our ability to comply with them. Given the lack of visibility of the Data Best Practice Guidance we do not consider it appropriate for a "best endeavours" obligation to apply and we would note that Ofgem has

¹ Statutory Consultation on the RIIO-2 Licence Drafting Modifications – reasons and effects: para 2.81

provided no explanation as to why such higher standard of performance is justified, in particular given the potential cost implications for consumers. We request that Ofgem provides a copy of the Data Best Practice Guidance as soon as practicable and strongly suggest that a “reasonable endeavours” obligation should be applied in respect of the licensee’s requirement to comply with it.