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Dear Hannah,

Re: Open letter on TPCR 5 – the way forward

Thank you for the opportunity to comment at an early stage on Ofgem's proposed way forward for TPCR5. The approach of issuing the document early and seeking stakeholders' active comment at this early stage is helpful. This non confidential response is on behalf of the Centrica group of companies excluding Centrica Storage.

As noted in our response to the equivalent letter on GDPCR2, we believe that our position as the largest gas/electricity shipper/supplier without affiliated network interests allows us to offer a clear and unconflicted perspective during the process.

While not wishing to restate all aspects of the group's responses to the RPI-x@20 review, we have welcomed the important developments in the area of RIIO and we look forward to seeing these benefits flow through to consumers. We recognise that Ofgem has, in the RIIO proposals set out the key principles in terms of financeability, pensions and output based regulation under which it expects TPCR5 to be formulated and delivered. This has been both helpful and constructive; however we do have some reservations as previously stated, in particular around the duration of the price control and the mid-term re-opener process.

For Centrica, the key issues under TPCR5 are set out below and expanded in the rest of the letter:

- TPCR5 is the only opportunity to ensure that the networks are adequately funded to achieve the massive network investment required to support achievement of the Government's 2020 Low carbon targets. The investment needed is widely estimated to be in the order of £4.6bn.

- "Network investment" needs to incorporate both normal and anticipatory investment, on a non-discriminatory basis and without imposing an undue cost burden on network users and consumers.

- The financeability and cost of capital arrangements must properly reflect the relatively low risk profile of the activity and explore more tailored approaches. In an eight year control, allowing the kind of "headroom" seen in the past poses an unacceptable risk to consumers. An indexed approach to cost of debt is more likely to achieve an acceptable balance of cost and risk.

- Transparency and enhanced stakeholder engagement will be vital to securing a balanced transmission price control, stakeholders must have access to sufficiently detailed information in a timely manner to enable them to play their full part throughout the process

The transmission network companies (especially in electricity) face massive challenges over the next eight years; as a result of the decision to move to an eight year control, this is the only real opportunity to ensure that network companies are able to fund the investment required to meet the government's 2020 targets.

To expect a new process to deliver against such targets on the necessary scale, and to do so economically and efficiently will bring its own set of challenges. While supporting the principles of well justified business plans and hence potential fast tracking of the price control process, we do have genuine concerns that under the circumstances a fast track option may not be appropriate. We believe it is likely to be in consumers interests that given this is the first application of the RIIO principles and the investment challenges; it may be preferable to exclude this option for this control. Instead, it could be made available in transmission for the control from 2021, based on the experience gained during TPCR5 and the greater certainty which is likely to be available in respect of future government targets at that point.

The importance of TPCR5 cannot be overestimated; it is pivotal to the achievement of the 2020 targets. This next price control must deliver the essential transmission network investment required. The document does not give sufficient attention to the risk of non-delivery in this area; much greater recognition of the issue is needed. We would also like Ofgem to set out how it will monitor progress and measure success as well as what criteria will be used for intervention in case it appears that the networks may not be on track to deliver.

When considering key aspects of the control, such as the cost of capital, it will be necessary to consider carefully the relative levels of risk faced in order to ensure this is factored in to the cost of capital. We continue to believe that this is not the same across the board, and that recognition should be given to the relatively low risk profile associated with anticipatory investment in electricity transmission. In particular, for electricity transmission investment there is plenty of evidence available for scrutiny and stakeholders have had opportunities to engage in the debates. It is clear to all stakeholders that the electricity transmission investment is needed and that the risk of the companies being left with under/un-funded or stranded assets is minimal. The cost of capital applied to such assets should, therefore, reflect this minimal risk.

We welcome the invitation to participate in the stakeholder workgroups, which we are happy to support. Given the contribution that non-network companies can make to such stakeholder workgroups we believe that this is a positive move. In our view it will be particularly important to achieve a good balance of stakeholder representation in the financing and safety & resilience workgroups. We have submitted a request to join these groups and will be happy to commit to the time necessary to support this crucial work.

Moving to the key issues set out in the letter, we agree that in general Ofgem has correctly identified the main areas of concern. We have set out our additional comments on a number of areas below, together with our observations on the table of outputs in Annex A.

Incentives:
While we accept there is a clear role for incentives in stimulating desired behaviours, as we have previously stated, it is essential to ensure that extra rewards are not provided for basic requirements (e.g. licence obligations) or areas which are incentivised/obligated elsewhere. Where the incentives relate to network investment projects, any innovation/stimulus package must be available to both the network companies and any competitors / related relevant stakeholders to enable wider engagement and effective competition with the networks to bid for funding, for example, LCNF. In addition, while formulating incentives, the impact on charges must not be forgotten. We have explained in our response to the GDPCR2 open letter how uncertainty imposes costs on consumers, the principles also hold true in transmission and these costs of uncertainty should be fully reflected when defining uncertainty mechanisms.

Electricity network investment:
We are in agreement that investment is required and that the level of uncertainty is significant, however we do not agree that the issues relate in such a pronounced manner to issues around renewable generation. There will undoubtedly be a change in the overall generation mix, but this issue needs to be looked at holistically , in the context of moving to the wider low carbon economy, as such the context for investment needs to address Low Carbon generation rather than just renewable.

The consideration under TPCR5 also needs to be extended to cover securitisation issues and how these will be addressed in the light of connect and manage, as well as potentially under co-ordinated onshore/offshore arrangements.

Gas and electricity transmission issues:
Centrica is particularly concerned that TPCR5 is flexible enough to address the significant need for anticipatory investment, while at the same time ensuring that the necessary investment is made as cost effectively as possible in the circumstances. This may not necessarily mean the lowest cost solution for a particular issue, but does need to demonstrate the best approach overall.

It is important that investment can be optimised between price control periods and address issues of integration both onshore and offshore. The outputs based framework will need to address efficiently these issues of co-ordination as well as considering the interactions between gas and electricity both in terms of incentives and network investment.

It is clear from workgroup discussions during the RPI-x@20 process that the network companies have periodically faced difficulties when addressing the requirements for longer term investments, and equally that eight years is unlikely to be long enough to resolve these issues, hence although TPCR5 will be the longest transmission price control to date, the issue of multi-control investment will still need to be addressed.

The area of incentives must be reviewed holistically as part of the TPCR5 process; we would recommend that this area form a separate workstream with enhanced stakeholder engagement. With the increasing issue of constraints in electricity which will need to be managed (at least in part by essential anticipatory investment) the interactions between gas and power incentives will need to be considered as well as the within fuel interactions between TO and SO. It would therefore be helpful to develop the incentive principles in parallel with GDPCR2. This would ensure consistency and avoid unintended cross Price Control impacts, while taking full account of any adverse impact on consumers through charges or underlying design issues.

Enhanced engagement:
As set out above, we are supportive of the process of using workgroups to assist engagement and we are happy to commit to this process. Recognising that there will be a range of working groups, as in the previous section, we would recommend the inclusion of a group on incentives and further a specific group to address issues around GBSQSS, which should not be subsumed within an HSE/Technical/reliability group and which should include evaluations such as the value/cost of lost load.

Annex A:
As a general comment, we would prefer to see an acknowledgment within the primary outputs that the costs of achieving the outputs need to be factored in. While the principles set out for the well justified business plans do acknowledge cost, continuing cost efficiency is not given sufficient emphasis. We support the principles associated with the well justified business plans, and in particular the requirements for enhanced stakeholder engagement. In order for stakeholders to play a full and constructive part, it will be necessary for the engagement process to explore carefully the full costs associated with the defined outputs. While it is likely that meeting government targets will incur cost, there should still be a consistent theme of economy and efficiency at the highest level to ensure continuing value for money for consumers.
In addition to the point above, we would like to better understand how Ofgem envisages issues such as Smart Grids and support for intermittency and greater interconnection being incorporated into the output measures.

Specifically in respect of gas transmission outputs, we believe that for the gas TO control, the baselines are critically important as a key primary output measure. As capacity is allocated via auctions, consistent, well-defined baselines are essential for participant confidence. The baselines need to be fixed early in the process; to be consistent with expectations drawn from previous controls and auction signals; and not changed without extensive consultation and notice.

In addition to these points, we have two observations under the headings given in the table:

- Environmental impact
  By anticipating investment, in principle, it should be possible to leverage synergies / economies of scale both economically and environmentally) i.e. by co-ordinating investments it is likely this will reduce the overall environmental impact – less assets = less material used and less construction impact. We believe that the environmental outputs should capture these benefits
- Reliability and Availability
  This area should include specific targets around GBSQSS, recognising that under this section, as well as environmental impact there needs to be a drive to understand and develop standards to minimise the amount of infrastructure required as well as ensuring the most is achieved from both new and existing assets – it is not clear that the current outputs would produce this desirable effect
- Conditions for connections
  It will be important to ensure that TOs do take responsibility for aspects within their control – for example, while they can't control the timing of the planning process, they can control the quality of the application and hence improve the likelihood of securing planning permission.

The principles underlying enhanced engagement also require a high degree of transparency and making full and detailed information available at an early stage. We welcome the transparency associated with some of the workgroup discussions, but believe that this will need to be extended to cover technical issues such as those associated with the GBSQSS and a note of all workgroups including those which may only include network companies, for example the network regulation manager discussions.

We would like to see an obligation placed on the network companies as part of this process to build the knowledge base of all stakeholders to ensure the best possible overall result. The challenges of delivering an eight year control under a new process which will enable the government targets to be met are significant and all stakeholders will need to work together effectively to deliver.

Finally, we would appreciate clarification on the potential interactions between TPCR5 and Project TransmiT, given the extensive nature of the project in terms of the future long term principles to be applied to transmission charging.

We trust these comments have been helpful and would like to meet with you and your team to discuss this response with you in more detail. If you would like to pick up any points in advance of a meeting, I would be happy to help and can be contacted on 07789 570046.

Kind regards

Yours sincerely,

Alison Russell
Senior Regulation Manager, Upstream Energy