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Dear Akshay,

RIIO-2 Draft Determination

I am writing on behalf of the Major Energy Users' Council (MEUC) representing the interests of a large number of industrial, commercial, retail and public sector organisations for which the use of gas and electricity is a significant factor in their operations' costs and whose total consumption is approximately 25% of the non-domestic UK demand.

May I begin by saying how difficult the task must have been for Ofgem to produce this draft determination with your team having to work from home and rely on technology to allow you to get together to form a consensus view on the nine business plans submitted to you last December.

I welcome your stated key objective of RIIO-2 to *“prepare the regulated network companies and ESO to deliver Net Zero at lowest cost to the consumer, while maintaining world class levels of system reliability.”*

Ofgem's views on net zero are to be welcomed, the rapid development of the thinking during the 15 months since Parliament passed this into law, and even since the business plans were submitted, will have to be matched with similar speed by transportation companies and Ofgem as we go into the RIIO-2 period.

Achieving this at the lowest cost to consumers must be applauded, especially as achieving the current reduced level of carbon in electricity generation, has made levies and taxes the highest portion of the bill (far exceeding the energy element) and making UK energy prices the most expensive in Europe.

The reduction in the rate of return was anticipated however, the proposed level of 3.95% appears to have caused shock in the industry and I do not feel qualified to comment on the level set.

The final part of the key objective, *“while maintaining world class levels of system reliability.”* I have severe doubts that this can be achieved if all the proposals in the Draft Determination are implemented.

For Major Energy Users Council members, security of supply comes only second to safety, a view strongly supported by stakeholder engagement in each of the business plans.

I believe all transporters will maintain the safety we have always enjoyed; however, my concern is that one way of maintaining safety is to remove a consumer's supply through isolation, thereby directly affecting security of supply.

My concern is the potential impact on security of supply linked to the large reduction in Totex in the draft determination. For the four transmission companies to face an average of 40%

reduction in Totex (55% in the case of National Grid Electricity Transmission) and the distribution companies 20% reduction would appear to be excessive.

I accept that large amounts have been moved into the Uncertainty Mechanism, however as things stand, the transmission companies must plan to receive 40% less revenue to run their business from April next year than they say they need.

This can only lead to major redundancies across the industry, with the associated loss of skills, as no company can employ staff on the basis that they may receive revenue from an uncertainty mechanism decision in the future. It could also lead to the use of casual labour to meet the variation in revenue, again putting security at risk.

Ofgem explained in their presentations that the transporters had provided insufficient evidence for the replacements they proposed, which had resulted in Ofgem moving a significant potential expenditure into the Uncertainty Mechanism (UM).

The companies report they have based their replacement revenue on the Network Asset Risk Metric and other tools, which I do not claim to understand. However, Ofgem's draft determination appears to have discounted this and applied what would appear to be zero based budgeting to asset replacement.

Moving Repex into uncertainty where a transporter must justify replacing a piece of equipment to the regulator before getting approval for doing so, must transfer the responsibility for failure from the transporter to the regulator and thereby make Ofgem responsible for security of supply.

An issue of concern for gas, the Draft Determination appears to have introduced a cut-off date of 2037 for asset lives raising a further concern that this could lead to a repair instead of replace regime that in turn can lead to increased failures thereby affecting security of supply.

Moving on to efficiency targets. I believe that most companies have included efficiency improvement targets in their plans that are higher than the UK average. Ofgem have used a consultancy who provided a range of improvement from 0.7% to 1.7% per annum.

Ofgem's use of the highest reduction on top of the companies' proposals are to be welcomed assuming they will have no negative impact on reliability and customer service, especially as the Ofgem waterfall diagram for gas distribution networks shows a reduction of 12.35% in their requested revenue linked to efficiency improvement.

Incentives are a major part of the price control, the RIIO-2 proposals shift the balance a company can retain through improvements, away from themselves and more towards the consumer. This must be welcomed unless it reaches a point where there is little incentive for the company to improve.

The companies entering the RIIO-2 period are facing proposed massive cuts to their potential spending and therefore will be faced with having to make significant cuts to their workforce as discussed earlier, with associated erosion of skills in the industry, which again links to security of supply concerns.

As things stand, with a 40% reduction in transmission and 20% distribution Totex, consumers should see a significant reduction in transportation charges from April 2021.

However, the impact of decisions as part of the UM during 2021/22 will be reflected in consumer charges for the following year. As electricity transmission and gas distribution give only two months' notice of change, this will add uncertainty for consumers. It will also lead to suppliers' building safety margins into their fixed price options, which will be inflationary.

Consumers do not welcome uncertainty and unpredictability in their energy charges.

Returning to Ofgem having moved a considerable potential expenditure into the Uncertainty Mechanism, which including net zero investment is said could exceed £10bn.

This must significantly increase the workload of both Ofgem and the companies. The speed of response will become critical, especially if the request were to replace worn out equipment. Ofgem do not have a reputation for making quick decisions, however with decisions to be made on £10bn a means of speeding up response time must be found.

This leads me to question how Ofgem will cope with,

- potential appeals to the Competition and Markets Authority (as has happened in the water industry),
- the electricity DNO RIIO-2 that has begun for 2023 – 2028,
- The need for speedy Uncertainty Mechanism Investment approval linked to £10bn of projects.

This could result in major recruitment for Ofgem with inexperienced staff being faced with making significant decisions. Not a welcome thought for consumers.

To summarize, at the launch of RIIO-1, it was said that the aim was to introduce certainty to the transportation companies to invest with an eight-year period and for customers to have predictability for their charges.

At the time Ofgem's Chairman, Lord Mogg said: *"Ofgem's new and innovative price control – RIIO – delivers a sound regulatory environment that protects consumers by attracting the energy infrastructure investment that Britain needs at a fair price. This provides a framework of strong incentives and penalties to stimulate the innovative and efficient operations of Britain's energy companies."*

I believe that RIIO-2 has abandoned this aim by shortening the period, adding uncertainty by transferring such a large sum into the uncertainty mechanism, reducing incentives, introducing variability of charges, and stifling investment by reducing the return that companies can earn.

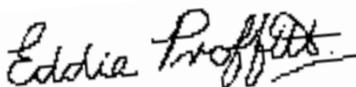
Finally, a great deal of publicity has been achieved through the release of your draft determination, with quite vivid headlines.

I would urge that the final determination is achieved through cooperation between Ofgem and the Companies and not through open warfare as was perhaps hinted at in some of the launch webinars.

I would see a referral to the Competition and Markets Authority to be a failure by both parties.

I appreciate the opportunity to express my views both here and in other forums and would be happy to discuss them further if it helped.

Yours truly,



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