

26 January 2022

## **RIIO ED2 Business Plans Call for Evidence**

Dear RIIO team,

Thank-you for the opportunity to contribute to the Call for Evidence on the ED2 Business Plans.

Until 2016 I was Senior Partner Networks at Ofgem and I led on RIIO ED1 including the subsequent appeal to the CMA. I am now working as an independent consultant and thought leader through my company Grid Edge Policy. I am also an Associate with the charity Sustainability First and a member of SSEN's Consumer Engagement Group. This response is provided in a personal capacity.

The area on which I wish to focus is on the Finance section of the plans and in particular the issues that Northern Powergrid (NPG) raise around the proposed change in asset lives, highlighting the significant burden this places on future consumers. The issue is also evident in SSEN's plan and the profile they provide of revenues – and hence bill - impacts out to 2060.

Given that the issues around the change in asset lives are complex and were explored in depth in the CMA appeal at ED1, I have produced a briefing paper (attached) which explains the issues and the history alongside recommendations for how I consider this should be taken forward. In the CMA appeal I said that Ofgem would revisit its approach to asset lives ahead of ED2 and am concerned that a proper review has never happened.

In the Sector Specific Methodology Decision Ofgem said *"We consider it is too early to decide on the useful economic lives of assets and treatment until we receive information from business plans and are able to fully consider the financeability and intergenerational fairness impacts of a 45-year economic life in the context of planned levels of expenditure during RIIO-ED2. The assumptions and scenarios underpinning business plans will feed into our review of regulatory depreciation, which we will consult on in Draft Determinations"*. Now does therefore seem the right time for Ofgem to consider this issue properly.

The issue of inter-generational fairness is a theme that I have been working on with Sustainability First (see for example my recent Viewpoint on the subject). It is clear from this work that Ofgem needs a clearer framework for how it makes these inter-generational trade-offs given its duty is to both current and future consumers.

While the idea that the asset lives used for depreciation should reflect the economic life of the assets sounds fair, significant problems arise in transitioning from one asset life to another as I explain in the paper. In summary I believe Ofgem should take seriously the concerns that NPG raise, reflecting as they do points that were made in the CMA ED1 appeal and supported by the CMA.

Taking this forward requires:

- **transparency** about what the long-term bill impacts would be under different options which has been absent from the consultations to date. This needs to look at the impacts out to 2060 not just over ED2.
- **an open debate** which needs to move away from being a technical discussion about financial parameters addressed deep in the annexes of regulatory documents to focus on the outcome we want to see in terms of the bill profile over time to deliver inter-generational equity (expressed in terms consumers could understand).

- **a pragmatic approach for ED2:** Ofgem then needs to work out how best to deliver that outcome. Inevitably, given where we are in the ED2 process, this will involve changes to existing parameters rather than more fundamental reform. A capitalisation rate that can vary year on year would seem the easiest change to make and could also potentially help with the new pressures resulting from the energy crisis and SOLR costs.

- **a commitment to a full review:** Ofgem does then need to commit to a more fundamental review of the approach to asset lives, perhaps drawing on the water model, ahead of RII03. This applies equally in the context of gas given the risks of asset stranding which Ofgem has suggested should be addressed through shorter asset lives.

I hope that you find this paper helpful in considering this specific aspect of the ED2 business plans. I also hope to use it with Sustainability First to take forward a wider debate on what we mean by inter-generational equity which I hope will be of interest to Ofgem.

Yours faithfully,

Maxine Frerk

Director Grid Edge Policy