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26 September 2023

Sent by email to: RegFinance@ofgem.gov.uk

Dear Rebecca

RE: Call For Input - Impact of high inflation on the network price control operation

Introduction

This call for input regarding inflation treatment within network price controls focuses on a vital aspect of the regulatory framework. The potential implications of changes to this policy could be very significant for customers, given that inflation linked returns in the form currently provided have been a cornerstone of GB energy regulation since privatisation. Now is not the time to make material changes given the need to secure significant investment to enable Net Zero.

Ofgem's current approach to inflation is fundamental to regulatory stability, therefore any potential change process has to be robust and subject to the highest levels of stakeholder scrutiny. Policy changes need very careful consideration, including the complex interlinkages and dependencies between regulatory framework components. We do not, therefore, support making any material changes to the treatment of inflation outside of a full price control setting process. Any changes, or signalling of changes, without rigorous and robust impact analysis will result in long-lasting damage to confidence in the regulatory framework with adverse consequences for increased customer bills and reduced levels of low carbon investment. Of the options Ofgem considers, anything that adjusts retrospectively is especially damaging to consumers interests, so retrospectivity (including any kind of clawback in future price controls) must be avoided.

ENWL's Core Principles

To aid our response to Ofgem's call for input process we have set out our core principles, shared here. These have been formed mindful of the substantial investment consumers need to achieve the low carbon transition.

Inflation protection has been a key cornerstone of the Regulatory framework since privatisation. This is a key reason why the stable regulatory regime has remained sufficiently attractive to investors to provide capital over the longer-term. In particular, the mechanisms by which investors are compensated for providing this capital are well understood and predictable. Any changes that break the link between returns on capital and inflation will undermine future investment and so it is imperative that inflation-linked returns remain in place.



No retrospection – Were Ofgem to consider retrospective action then it would fundamentally undermine a price control process that has been built on regulatory predictability and long-term stability. Anything that challenges predictability as a core principle will inevitably lead to higher investor risk and higher financing costs for consumers in their bills.

Actual v notional and impact on the whole framework – these core principles are directly linked to shareholder expectations and requirements. Whilst it is inappropriate to make an isolated change to one element of the inflation package as a response to a perceived short-term issue, it may be more appropriate to consider the wider financing approach within the normal periodic price control review cycle. Any analysis on potential options needs to be done within a well understood wider policy framework and consider all impacts, particularly the actual (rather than just notional) company. Given that the logical course of action implied by Ofgem’s call for input policy options would have to apply only to the actual company, it would therefore seem appropriate that an in-the-round assessment of an actual company impact is required. Important considerations such as financeability can only be considered in the context of other policy decisions on price control components.

Considerations for policy design and implementation

In the context and consideration of the core principles outlined above we agree with Ofgem that the subsequent “Principles for policy design and implementation” of Financial resilience, Policy symmetry and Managing the pace of implementation are all key in the consideration of any policy action in its design and implementation. We additionally suggest a principle is added that, **“A full in-the-round impact of changes to the price control and individual licensees (Actual) has been robustly assessed to avoid adverse unintended consequences for consumers”**.

Importantly, **we do not agree** with Ofgem’s assertion on page 1 of the call for input which suggests there has been an explicit existing policy objective of keeping real equity returns stable relative to inflation over time.

We are not aware of Ofgem having set out any such policy prior to the call for input. It would be wrong to characterise the recent variations as being inconsistent with policy intent.

Criteria for Evaluation

We agree that Protecting consumer interests, Ensuring prices are fair for the consumer and are efficient, Regulatory stability and predictability, Optimal allocation of risk, Price control legitimacy and Credibility of voluntary plans submitted are all sensible criteria for evaluation.

However, having reviewed the list in the context of our core principles we have identified that the evaluation criteria should be extended to include:

1. An in-the-round actual company impact assessment;
2. Reviewing whether the policy option has a sound theoretical underpinning or moves away from well-established finance theory and expectations;
3. The implications for achieving necessary low carbon investment which may be restricted if there is increased investment risk or lower rewards for investment.

Of the policy options Ofgem advances we strongly favour, “No policy action in relation to this issue” as the most appropriate conclusion for consumers at this time. We do acknowledge that, “Changes to future price control design” are indeed matters Ofgem naturally considers, but these must be developed in-the-round as part of the price control development and setting process. Our suggestion concerning the electricity distribution sector is that the proper place for a policy evaluation is in developing the RIIO-ED3 price control.

This response should be considered alongside the ENA response to the call for input, which we fully support.

Please see confidential appendix 1 for our actual ENWL specific impact assessment.

Yours sincerely

A handwritten signature in black ink, appearing to be 'PB', written over a light blue horizontal line.

Paul Bircham

2023.09.25

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Paul Bircham

Safety, Compliance and Markets Director

Encs: Appendix 1