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Friday 18 June 2010

RPI-X@20 – Longer-term price controls

Dear Hannah,
Firstly, we at Central Networks are keen to play our part in the debate around what our regulatory framework should look like in the future.

Having attended a number of Industry Working Groups, and also attended a recent presentation by you at the ENA, I wanted to re-iterate my key views on the length of the price control.

It is clear to us that regulatory change has the potential to allow DNOs to contribute more to a sustainable and low carbon future for the benefit of our customers. The length of the price control is an important element which will drive longer term efficiency and hence future cost.

Framing the opportunities
Concerning longer term price controls, we would like to start by framing the opportunities.

Extending elements of the price control will bring two types of benefits:

- Improve efficiency of longer term decision making, either by better aligning costs and drivers e.g. a new circuit to connect potential onshore wind in the future, or by aligning costs and benefits. Networks and network assets are particularly long lived and hence extending the relevant areas of the price control will improve that decision making.
- Reducing both the administrative burden, and the company focus to a more efficient level.

Setting an 8 year price control stands to reduce the administrative/company focus burden provided the 4 year review is more a review than a significant reopener. However, it must also be noted that company focus and administrative burden would initially be increased in setting up, agreeing on, and assessing the risk of the new price control mechanism in the first place.

Most of the benefits for customers will however come from improved long term decision making, for example network design and construction where most of the drivers would reveal themselves beyond the proposed 8 years. At the moment it is not apparent why 8 years is suggested or why this is the optimal length?

The proposed solution

At the moment we would characterise the straw man as having 80% of the price control fixed for 8 years with maybe 20% subject to a review after 4 years.

Given that most of the benefits to customers would be generated through improved asset management, we believe these elements of the price control should be agreed over much longer periods of around 20 years. This would primarily be focused on volumes of investment and maintenance to optimise these over a prolonged period and should also include key outputs associated with these costs e.g. network performance, losses etc.

5 year reviews would remain for other parts of the price control, dealing with variables exogenous to the control of the company e.g. underlying costs, changes to the environment in which we operate, financing and pensions etc.

We would characterise such a price control as having a smaller element fixed over the longer term i.e. 20% over 20 years, and the remaining element fixed over the current 5 year period. This, we believe, would generate significantly greater benefits for customers than the existing straw man.

At this point it is important to separate this proposal from the debate concerning the allocation of risk between customers and DNOs that can be adjusted subsequently through the appropriate incentive rate.

One of the key elements of an extended price control that came out of the workshop was the impact on volatility of network prices. Potentially, the longer the price control, the greater the 'logging up' of costs and benefits to pass on to future customers. This contrasts with a more complex price control which encapsulates annual variations to pass such factors through to customers on a more immediate basis. DNOs should be expected to work harder to ensure transparency remains such that this increased volatility is not passed through to customers in higher overall prices.

In summary

We feel that increasing the duration of the price control will significantly aid long term decision making which will provide a real benefit to customers. However, it is unclear why Ofgem deem 8 years to be optimal and we believe something more akin to 20 years for specific elements would be more beneficial to customers.

All other elements that are not capable of being managed by companies in the longer term should continue to be assessed over a duration of 5 years.

If you have any questions on the contents of this letter please don't hesitate to contact me.

Yours sincerely

Jonathan Ashcroft
Regulation and Commercial Manager