Central Networks
Pegasus Business Park
Castle Donington
Derbyshire
DE74 2TU
central-networks.co.uk

Jonathan Ashcroft
T 02476 185766

jonathan.ashcroft@central-networks.co.uk

Hannah Nixon
Partner Regulatory Review
Ofgem
9 Millbank
London
SW1P 3GE

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RIIO – "RPI-X@20 recommendations July 26th

Dear Hannah,

Thank you for providing us with the opportunity to respond to the RIIO recommendations which came out on the 26th July. At Central Networks, we are keen to contribute to the debate as to how we create a regulatory framework which empowers the energy industry to deliver long term value to our customers, whilst facilitating the move to a low carbon economy and ensuring reliable supplies.

On the whole we see the recommendations document as a mature step forwards from the strawman outlined previously. All parties want DNOs to be efficiently financed and we feel that this is a key area in which the debate must take place at this point in the review. We support the industry response from the ENA and urge you to consider this in depth.

Strong forward thinking

We are confident in the regulatory foundations that underpin the RIIO proposals, and are pleased to see that delivery of our outputs will be at the centre of the regulatory framework in the future.

We also see greater incentives on the quality of our business plans as an enabler to allow us to improve delivery in the long term through strong, well justified planning. We agree with the emphasis on stakeholder engagement, given the scale of the changes that energy networks now face. We see this as essential to ensure that changes result in optimal solutions for stakeholders and network companies alike.

Central Networks East plc
2366923

Central Networks West plc
3600574

Central Networks Services Limited

Registered Office:
Westwood Way
Westwood Business Park
Coventry CV4 8LG

A step in the right direction

We welcome the extension of the incentives within the price control to eight years, as it gives some more confidence to make investment decisions on trading off upfront investment to save money in the medium term. We are, however, not convinced that eight years is the right answer and there may be scope to extend this further where investment is expected to bear fruit over a longer term. This may be the case for the implementation of smart grids, for example.

Similarly, the implementation of smart grids may require some revision to the framework of output measures. Investment to move towards smart grids will include such revision to upgrade the network in terms of remote sensing and control. This investment will not contribute to improving the key output measures of load or health indices, indeed these values could "worsen" in a smart grid scenario where we would expect the additional flexibility and information to allow the network to be operated closer to the operational limits. Smart Grid development will benefit customers, due to the avoided costs of large scale reinforcement. This benefit should be recognised in the output measure framework.

We also respect Ofgem's firm stance as gatekeeper to the third party right to challenge price controls, with issues tackled in isolation. This instils confidence that whole price control settlements will avoid the risk of a delayed process as a result of a challenge.

Whilst we like the prospect of incentivising DNOs by fast tracking their price control process, we would like to know more about how this would work when the price control agreement for the industry is still on the table. Price control reviews take a long time and any basis for speeding it up is welcomed. However, we remain concerned at the potential subjective nature of any differentiation and with the detail provided at the moment are yet to be convinced that the process can work and be fair

Efficiently financing DNOs should be reconsidered

We recognise how important the balance is between ensuring that DNOs are financeable and giving customers a fair deal. Current customers, whilst paying for new investment over twenty years, are not paying for historic assets which were depreciated more rapidly following privatisation and we feel that the existing balance is fair for them and for future customers. This is why it is important that any transition arrangements should focus on changes to the lives of new assets, rather than old ones. Any other arrangements, at a time of high investment, will reduce the attractiveness of investment in UK networks and

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push out cost unfairly onto future customers

We cannot support the approach taken in the RPI-x@20 consultation that investors are neutral or indifferent to cashflow timing if there is no change to the WACC. The risk introduced from longer term cashflows, driven by the risk of changing regulation, means that future increases in depreciation periods would need to be reflected in the WACC for all types of investor. We also refer you to Oxera's paper ('Cash-flow profiles and the allowed WACC – a response'), prepared on behalf of the ENA, which outlines the arguments to support this. The issue of financeability is particularly important coming into periods of high investment, combined with the uncertainty over the future of energy.

We wrote to Scott Phillips in June to express our concerns and append that letter to this one, as in essence our points are the same ones and have not changed significantly since then. We would appreciate your time to consider the points we have raised and to recognise the importance of short term ratios for companies and the link between the WACC and depreciation periods.

Final thoughts

We feel your recommendations demonstrate a big step forward on most issues, but the issues around financeability need to be reconsidered in light of the information we have provided to you.

Yours sincerely

Jonathan Ashcroft
<u>Regulation and Commercial Manager</u>