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Dear Hannah

Open letter consultation on the RPI indexation of allowed revenue in the forthcoming RIIO price controls (T1 and GD1) and the TPCR4 rollover.

EDF Energy is one of the UK's largest energy companies. We provide 50% of the UK's low carbon generation. Our interests include nuclear, coal and gas-fired electricity generation, renewables, combined heat and power plants, and energy supply to end users. We have over 5 million electricity and gas customer accounts in the UK, including both residential and business users.

We welcome the opportunity to respond to this consultation. The key points of our response are as follows:

- We remain to be convinced that the RPI Indexation is a fundamental issue that needs to be resolved, or a temporal issue caused by a specific period of negative RPI that will pass in time.
- Further consideration should be given to the proposed RPI Indexation methodology in terms of whether or not it delivers unexpected revenues to the network owners.
- One of the benefits of the current methodology is that interested parties can replicate the RPI calculations and so forecast the impact on charges. Moving to a forecast RPI with a correction mechanism might introduce further instability in this area and have a negative impact on predictable charges.
- Were Ofgem to implement reform, then Ofgem's proposed solution is the most appropriate, as it removes any risk from inaccurate forecasts. It would also be appropriate to couple this methodology with the RPI forecast for the UK economy produced by HM Treasury.

The driver for this consultation has been the period of negative inflation that occurred between October 2008 and March 2009. The result of this is that the network owner's inflation rate that will be used to determine allowed revenues for the financial year will be set at -0.5%; this compares to an actual inflation rate for the period of 5.0%. This issue is being driven by the fact that the Licence formula which determines RPI compares the average for July to December in year -1 with the average for July to December in year -2. As noted in the consultation document, historically any under or over recovery for a particular year has generally been countered over the period so that overall the network owners have remained neutral to any gains in any particular year. The concern is that with this price control, setting a very low (negative) RPI at the start of the period will not be countered by a higher allowance later in the period, resulting in an overall cost to the

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network owners. This is an issue that has been brought to a head as a large divergence has been identified at the start of a price control period; so, it is not clear that this represents a fundamental flaw in the RPI indexation process.

In the financial year 2008-09 the network owners were allowed revenue based on an inflation rate of 4.1%. From the figures published by the ONS, the change in RPI over this period was actually -1.2%. For the rest of the price control period the allowed and actual rates of RPI were similar; and so the issue focuses on the RPI indexation for the years 2008-09 and 2010-11. There is therefore a risk that focusing on the RPI indexation for 2010-11 will result in the additional allowance that was earned from 2008-09 not receiving the same attention. Any solution to address the issue of RPI indexation in 2010-11 must take into account the uplift to revenues in 2008-09; otherwise a change in policy could result in a significant benefit to the network owners.

We also recognise that if an RPI indexation mechanism was designed from scratch, then with the benefit of hindsight creating one with a timelag effect might not be appropriate in a period of volatile inflation. Ofgem's preferred approach would appear to address this issue by using a forecast RPI level; while including a truing up mechanism to address the issues associated with the inaccuracies in the RPI forecast. This is likely to protect consumers from funding the networks based on a high RPI forecast, when retail inflation turns out to be low, or negative' in line with Ofgem's primary duties. At the same time we recognise that Ofgem's truing up mechanism could create further instability in transmission charges as the forecast inaccuracies are corrected. The issue of unstable transportation charges has been flagged up through TransmiT and should be given further consideration when developing an RPI indexation mechanism. A potential solution might be to require the TOs to provide a regular update to industry on the impact that any RPI correction mechanism will have on charges.

Finally, we support Ofgem's proposal to use the HM Treasury Forecast for the UK Economy when forecasting RPI. This is a publicly available forecast which will aid transparency and reliability for interested groups. Further as it represents the average of numerous independent forecasts the risks of revenue being skewed by an extreme forecast, which goes against general market perceptions, are minimised.

I hope you find these comments useful. Please contact my colleague Stefan Leedham on 020 3126 2312, if you wish to discuss this response further.

Yours sincerely

Rob Rome
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