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Hannah Nixon
Ofgem
9 Millbank
London
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Dear Hannah,

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

Wales & West Utilities Limited (WWU) is a licensed Gas Distribution Network (GDN) providing Gas Transportation services for all major shippers in the UK. We cover 1/6th of Great Britain and deliver to over 2.4 million supply points. WWU is the only Licenced Operator that focuses solely on Gas Distribution in Great Britain.

We appreciate National Grid (NG) raising this issue and for the opportunity to respond to this open letter consultation. Having reviewed the calculations that support NG's concerns, we would agree that the current proposed approach to indexing allowed revenue in RIIO-T1, RIIO-GD1 and TPCR4 rollover may not provide sufficient protection against economy wide inflation.

In principal, WWU support the proposed approach set out in the consultation. We have identified a number of practical issues that should be considered before a final decision is made and these are discussed below.

Whilst we agree that the proposed approach to replace the lag in RPI indexation in favour of forecast RPI with an ex post adjustment would provide protection for network companies against economy wide inflation, this approach does not fully mitigate inflation risk faced by network companies in the short term. The ex post adjustment must operate with a two year lag to enable full year RPI data to be included in the adjustment. This two year lag creates short term inflation risk for network companies as volatile or inaccurate RPI forecasts may create large fluctuations in cashflows.

The use of forecast RPI will only be valuable if forecasts are reliable and accurate. In order for prices to be set in advance of the formula year, forecasts may need to cover a period of up to 18 months. In the current economic climate, forecasting inflation for a relatively short period is problematic let alone 18 months. The success of this approach relies heavily on inflation remaining relatively steady and if in the future we see large fluctuations as in recent years, significant forecast risk will be imposed on network companies resulting in cashflow issues.

Choice of forecast

We agree that HM Treasury Forecast for the UK Economy would be practical however there is a concern that treasury forecasts may be influenced by a desire to hit a target CPI. This should be considered when assessing the reliability of these forecasts.

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The costs of an Ofgem commissioned forecast of RPI would likely be funded through the licence fee which would result in additional cost to the end consumer. The option for each network company to complete their own RPI forecast is not practical. Not only would this create additional work for the network companies and require skills which may not currently be present, variations in forecasts would be heavily burdensome on suppliers who operate across more than one network.

We therefore would agree that forecasts contained in the HM Treasury publication would be most suitable if this proposed approach were adopted.

Yours sincerely,

Steve Edwards

Head of Commercial and Regulation

Wales & West Utilities