



To shippers, suppliers, network companies, consumers and their representatives, investors and other interested parties.

*Promoting choice and value for all gas and electricity customers*

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Dear colleagues

### **RIIO-T1/GD1: Office of National Statistics (ONS) review of Retail Prices Index (RPI) methodology**

We are currently undertaking price control reviews for gas and electricity transmission networks (referred to as RIIO-T1) and gas distribution networks or GDNs (RIIO-GD1). The price control reviews will set out the outputs that network companies will need to deliver, and the revenues we will allow them to recover from their customers for delivering the prescribed outputs, for the period 2013-2021.

In July 2012, we published Initial Proposals (IP) for National Grid Electricity Transmission (NGET), National Grid Gas Transmission (NGGT), as part of RIIO-T1, and the GDNs as part of RIIO-GD1.<sup>1</sup> This letter sets out a further issue where we are seeking stakeholders' views in relation to the Office of National Statistics (ONS) review of its RPI methodology.

We would welcome respondents' views on the issues set out in this letter by **Tuesday 27 November 2012** to [RIIO.GD1@ofgem.gov.uk](mailto:RIIO.GD1@ofgem.gov.uk). Unless marked confidential, we intend to publish responses on our website.

#### **The issue**

The ONS is currently reviewing its methodology for calculating RPI.<sup>2</sup> In particular, the review is examining the reasons for one of the differences between the retail prices index (RPI) and consumer prices index (CPI) (known as the "formula effect"), and whether recent increases in the formula effect mean that the ONS should revise its methodology for calculating RPI. The ONS issued a consultation on its proposed options regarding the RPI methodology in October, and intends to publish its recommendations in January 2013.<sup>3</sup>

We did not consult on options to address any implications of the ONS review within our July IP as the ONS only published its consultation in October. However, in their responses to our IPs for both RIIO-T1 and GD1, a number of network companies stated that any changes to the calculation of RPI arising from

<sup>1</sup> See: For GD1, see: Ofgem (July 2012) RIIO-GD1 Initial Proposals – Overview. Link: <http://www.ofgem.gov.uk/Networks/GasDistr/RIIO-GD1/ConRes/Documents1/GD1%20Initial%20Proposals%20Overview%2027July12.pdf>. For T1, see: Ofgem (July 2012) RIIO-T1 Initial Proposals for NGET and NGGT – Overview. Link: <http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=214&refer=Networks/Trans/PriceControls/RIIO-T1/ConRes>

<sup>2</sup> See link: <http://www.ons.gov.uk/ons/about-ONS/user-engagement/consultations-and-surveys/national-statistician-s-consultation-on-options-for-improving-the-retail-prices-index/options-for-improving-rpi-consultation-document.pdf>

<sup>3</sup> For high level timetable,, see ONS press release: <http://www.ons.gov.uk/ons/rel/mro/news-release/national-statistician-consults-on-changes-to-retail-prices-index/nsconsultrpinr1012.html>

the ONS review may inhibit their ability to recover their costs. This is because base revenues are indexed by RPI, and the RAV is updated to reflect RPI at each price control review. The network companies considered that we should include a provision for a reopener in the licence to address any implications of this, should the ONS consultation result in a decision to change the RPI methodology.

We believe that it is appropriate to consider the impact on network companies of any change to the methodology to calculate the RPI arising from the current ONS review. Our preliminary view is that we should include a provision for such a review within the network companies' respective licences.<sup>4</sup>

In broad terms, we would propose to include a provision for a reopener which would provide networks with the right to make a request to us to reconsider their allowed revenues in the event of a change in ONS' methodology for calculating RPI. The reopener would only consider the impact of changes to allowed revenues arising from the ONS review. We also propose that the reopener could be triggered by us. We would also need to consider further details of how such a reopener would work including:

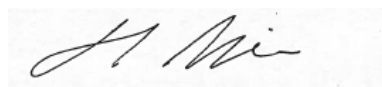
- whether the request from an NWO should be subject to a specific application window, eg in line with other uncertainty mechanisms.<sup>5</sup> The objective of the application window would be to ensure that we receive applications for a reopener from NWOs simultaneously so that we can compare them. This helps our decision-making, and reduces regulatory costs. The use of an application window also improves certainty in relation to the expected timing of any changes to NWOs' allowed revenues and therefore helps improve the predictability of network charge changes.
- whether to require a materiality test to be met before implementing any change, and if so, at what level. For example, we could require NWOs to demonstrate that the change in expected net revenues over the price control was greater than 1% of their regulated revenues. The purpose of a materiality test would be to avoid making changes where any change to the ONS methodology results in an immaterial impact on NWOs, so helping to minimise regulatory costs.

## Next steps

We will take into account respondents' views before setting out our decision in Final Proposals for RIIO-T1 and GD1 on 17 December 2012.

If you have any questions in relation to this consultation please contact James Grayburn at [james.grayburn@ofgem.gov.uk](mailto:james.grayburn@ofgem.gov.uk) (or 020 7901 7483).

Yours sincerely



**Hannah Nixon**  
**Senior Partner: SG&G - Distribution**

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<sup>4</sup> We are currently undertaking a second informal licence consultation for RIIO-T1 and GD1. Within this consultation, we include the potential provision of a licence condition in relation to the ONS review of RPI ([ETC/GTC/GDC 139] Special Condition - Changes to RPI inflation methodology. See:

[http://www.ofgem.gov.uk/Networks/Trans/PriceControls/RIIO-T1/ConRes/Documents1/RIIOT1andGD1\\_2nd\\_licence\\_draft\\_consultation.pdf](http://www.ofgem.gov.uk/Networks/Trans/PriceControls/RIIO-T1/ConRes/Documents1/RIIOT1andGD1_2nd_licence_draft_consultation.pdf)

<sup>5</sup> See: Uncertain Costs [ETC/GTC/GDC28] in the above consultation.