

Legal & Regulatory

1st Floor, Lakeside West
30 The Causeway
Staines
Middlesex
TW18 3BY

Hannah Nixon
Senior Partner
Smarter Grids and Governance
Ofgem
9 Millbank
LONDON
SW1P 3GE

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Dear Hannah,

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

Thank you for the opportunity to respond to Ofgem's consultation, RIIO-T1/GD1: Office of National Statistics (ONS) review of Retail Prices Index (RPI) methodology, document 141/12. This is a non-confidential response on behalf of the Centrica Group excluding Centrica Storage.

We do not believe it is appropriate to protect networks from changes to the RPI methodology resulting from the current review:

- To provide networks with protection from changes to the RPI methodology would appear to be providing networks with greater protection than holders of government bonds;
- Networks have enjoyed windfalls from previous changes to the calculation of RPI and the effect of a proposed price control re-opener would be to lock in these windfalls, to the detriment of consumers.
- The overall impact of RPI changes on networks is unclear as we do not know to what extent contracts and pay settlements are linked to RPI, and how networks plan to update this in light of any changes to RPI.

The current ONS consultation states that the Bank of England will need to be consulted on whether any change to the RPI methodology would be materially detrimental to the interests of holders of each relevant index-linked gilt, and if it concluded that this was the case, then consent would be required from the Chancellor of the Exchequer before any change could be made. Including a price control re-opener to protect networks from changes to the RPI methodology would therefore appear to be providing networks with greater protection than holders of government bonds. We would expect this to have significant implications for the cost of equity allowed in price control settlements.

The current ONS review seems to have been initiated due to the effects of another change in 2010 – **ONS price collection guideline changes for clothing prices** – which has caused RPI to increase by circa 0.5% relative to CPI. This increase in RPI has provided unexpected benefits to all network companies. The ONS consultation is quite clear that this increase in RPI from 2010, and the increase

in the 'formula effect' difference between RPI and CPI, has been caused by the weaknesses in the current methodology for calculating RPI. The additional revenues that networks have received as a result of the 2010 change can therefore be viewed as windfalls.

To provide protection to networks against a review which is seeking to correct for the flaws which has caused the increase in RPI since 2010 would lock in this windfall to the detriment of consumers. It would in effect mean that network companies continue to receive cumulative revenue increases which are c. 0.5% higher than they should be due to the combined effect of the RPI averaging methodology and the changes made in 2010 relating to the treatment of clothing prices.

We believe that the appropriate approach is to allow the networks to retain the windfalls received as a result of the 2010 ONS price collection guideline changes for clothing prices, but to provide no further protection against changes to the RPI methodology which prevent these windfalls going forward.

In the event that a re-opener is still deemed necessary by Ofgem, we would expect this to be accompanied by a corresponding reduction in the cost of equity to reflect the significant reduction in risk faced by networks.

We would also expect the determination of any additional revenue allowances to be based on evidence provided by the networks that shows that contracts and pay settlements linked to RPI will also be updated to reflect the methodology change rather than simply be a revenue calculation based on RPI on the old versus new basis. Any determination should also take account of the benefits received by networks since the RPI change in 2010 associated with clothing prices, as well as the benefit that will be received by the other change listed in the ONS consultation (Measuring private housing rental prices in the RPI and CPI) which is expected to add 0.1% to RPI from February 2013.

I trust these few comments are helpful, if you have any questions regarding any of the points raised in this response please do not hesitate to get in touch.

Kind regards,

Andy Manning
Head of Network Regulation, Forecasting and Settlements
British Gas
[via e-mail]