

26 September 2014

Mr James Goldsack
RIIO ED1
Ofgem
9, Millbank
London
SW1P 3GE

Dear James

RE: Consultation on the Treatment of Real Price Effects for the RIIO-ED1 Slow Track Electricity Distribution Network Operators (DNOs)

I am writing on behalf of Energy Networks Association (ENA), the voice of the networks. ENA is the industry body for UK and Ireland gas and electricity transmission and distribution networks, essentially, the 'wires and pipes' that deliver this vital service to our homes and businesses.

ENA members welcome the opportunity to respond to the consultation on the Treatment of Real Price Effects (RPEs) for the RIIO-ED1 Slow Track DNOs and this response is made solely on behalf of these companies.

The introduction of an RPE index would:

- have the effect of moving the risk associated with RPEs from DNOs to customers;
- not appropriately reflect DNOs' RPE cost pressures, with the effect of introducing greater risks for DNOs as allowances will not reflect costs, if implemented in the form Ofgem has proposed; and
- reduce or even remove any incentive on DNOs to manage RPEs, if implemented in a way that matches the RPE pressures DNOs actually experience.

As a consequence, the proposed RPE Index would also create uncertainty and price volatility for consumers and would not mitigate the risks to the DNOs of changes over time. In particular, an index would not be consistent with the requests suppliers have made to Ofgem, as detailed in the 4 October 2013 consultation on the timing of a decision on electricity distribution network revenue, which stated "Suppliers have indicated that volatility in network charges, the way each DNO recovers the cost of operating its system, is a key concern. Some suppliers have indicated that in order to manage the risk of unexpected changes in revenue they include a risk premium in consumers' energy bills to compensate them for bearing this risk. We agree that the ability to predict charges with a degree of accuracy is important for suppliers and ultimately energy consumers."

The DNOs believe that the most appropriate course of action for Ofgem to follow is to set appropriate allowances for RPEs for Slow Track DNOs and to recognise the increasing risks associated with managing RPEs over an eight year period within its wider cost of equity assessment. The approach taken by Ofgem in setting RPE allowances in its Draft Determination for Slow Track DNOs is not fully justified as it contains a number of anomalies that have a material adverse effect on proposed allowances.

ENA has commissioned Frontier Economics and NERA to carry out pieces of work to analyse the proposed Real Price Effects as set out in the Draft Determinations. NERA estimate that RPEs in ED1 should be around 0.85% per annum higher than those included in the Draft Determination (£274m higher for Slow-Track DNOs). Frontier Economics estimate that RPE allowances for Slow-Track DNOs would have been £343m higher than those in the Draft Determination if Ofgem had used the approach the Competition and Markets Authority (CMA) took in the Northern Ireland Electricity inquiry once this approach is aligned with the ED1 basis for uplifting allowed revenues using annual average RPI inflation. The final versions of their reports are attached to this response as appendices.

The DNOs have met members of the RIIO ED1 team to discuss Ofgem's approach to setting RPE allowances in its Draft Determination and proposed ways forward.

I trust that you find these comments useful. We would be happy to meet with you and the relevant members of your team to discuss them further.

Yours sincerely



David Smith
Chief Executive

Attachments:

- Frontier Economics - CMA RPEs methodology in NIE inquiry applied to GB DNOs
- NERA - Review of Ofgem's Draft Determination of Real Price Effects for RIIO-ED1