



Kersti Berge
Senior Partner Electricity Transmission
Ofgem
9 Millbank
London
SW1P 3GE

Your ref
Our ref SWWCM201411
Name Jonathan Wisdom
Phone 07584 491508
E-Mail jonathan.wisdom@npower.com

24th November 2014

RWE response to Ofgem's "consultation on our assessment of the Caithness Moray transmission project"

Dear Kersti,

This response is made on behalf of all RWE companies within the UK

Thank you for this opportunity to respond to your consultation regarding the recovery of revenue related to the Caithness Moray transmission project. Ofgem has a critical function in reviewing the proposed costing for Strategic Wider Works (SWW) projects – we welcome all efforts to challenge costs in order to ensure that network investment is delivered as efficiently as possible to bring best value to end consumers. The cost reduction challenge is therefore welcomed.

We also understand the need to improve the transmission infrastructure to ensure timely connections and efficient costs; however, we are very concerned about the potential disturbance to electricity transmission prices that the proposed cost recovery will cause in 2015/16. This is exacerbated to customers as following the implementation of CMP224 more of the total revenue will be charged directly to demand leading to more acute price impacts to consumers. Our preference is for this revenue recovery to be delayed until 2016/17 tariffs – this will not cause delays to the 2018 delivery of Caithness Moray but importantly will allow consumers and the market to take proper account of this step change.

We have several key concerns that relate to this unexpected revenue increase:

- The effect on larger consumers with pass-through contracts of managing these higher costs.
- The deviation from the published SWW guidance.
- The implications for market participants risk if these late notice changes continue through the Strategic Wider Works programme.

Impact on larger customers with pass-through contractual arrangements

The implementation of these (Caithness Moray) revenues into 15/16 tariffs will mean those customers who have a pass-through contract with their supplier will see these increases directly affect them next year. We do not consider that this is of benefit to consumers in the short or long term or of benefit to UK plc as a whole. We believe that

RWE npower

2 Princes Way
Solihull
West Midlands
B91 3ES

T +44(0)121 336 5100
I www.rwenpower.com

Registered office:
RWE Npower Group plc
Windmill Hill Business Park
Whitehill Way
Swindon
Wiltshire SN5 6PB

Registered in England
and Wales no. 8241182



the creation of stability and confidence within the energy market at this time is of paramount importance. Decisions that deviate from this are not positive either in terms of industry perception or consumer trust. Delaying the incorporation of this revenue into the price control until 2016/17 would allow customers the opportunity to manage the introduction of these higher costs into their own business plans. Several of our larger customers have expressed their concern about this short notice volatility and the impact it will have on their own businesses. We believe that appropriate consideration of their concerns is of paramount importance in this process.

Deviation from published Strategic Wider Works Guidance

The Strategic Wider Works process was created to manage uncertainty around revenues that could not be agreed prior to the agreement of the RIIO-T1 business plans for the Transmission Network Owners. The factsheet¹ released on Ofgem's website specifically states that the process will help to manage uncertainty and ensure value for money. In the case of Caithness Moray this late notice introduction of revenues does not fulfil this aim and may well lead to increased costs for consumers in the future as market participants will increase risk premia to manage this uncertainty.

The factsheet also provides a timeline. This defines that there will be a 3 month final decision consultation period and 4 month licence modification period. Deviating from these does not encourage confidence in the electricity market or the SWW process. This process will in fact have been accelerated by circa 6 months if revenues are allowed into the 15/16 tariff process. As this project is of a massive scale in terms of costs we do not consider this appropriate for any acceleration of timescales. The factsheet also states that the larger and more complex projects are expected to take longer to proceed through the process. As this is a larger project we would expect more time to be required to fairly assess the costs and outcomes of the project.

Finally, we do not believe that some of the key tenets of the RIIO framework around stakeholder engagement have been fulfilled. In our view Strategic Wider Works, as an uncertain element of the RIIO-T1 price control, should be discussed openly in industry fora by the relevant TO to ensure that stakeholders are aware of all aspects of the project. This ultimately includes all market participants who will be responsible for these costs. We do not consider that this has taken place for any SWW project to date and attempts to gain clarity on the scale of funding, likely implications for revenues and further transparency have not been met by SHETL in the case of Caithness Moray. This is also true of National Grid who in their TNUoS tariff forecasts have been unable to appropriately reflect the cost of the Caithness Moray revenues and therefore, through no fault of their own, have been providing the market with incomplete information. We do not believe that this fulfils the requirements of CMP206 and does not meet the intent of this change to provide transparency in transmission network prices.

Market transparency and the likelihood of increased risk

Ofgem's revenue volatility consultation and decision to mitigate its effects in the price control settlement² were welcomed by industry participants. Good progress has also been made in this regard with Ofgem's positive consideration of DCP178³ and the acknowledgement that reducing risk meets applicable code objectives and also Ofgem's statutory duties with regards to protecting the interest of consumers.

It is our belief that decisions to incorporate additional revenue at short notice into charges runs counter to the above considerations from Ofgem and will result in more risk being borne by market participants. The total Strategic Wider Works expenditure across the RIIO-T1 price control according to the "Guidance on Strategic Wider Works arrangements in

¹ <https://www.ofgem.gov.uk/ofgem-publications/85263/strategicwiderworksfactsheet.pdf>

² <https://www.ofgem.gov.uk/ofgem-publications/50572/cvdecision.pdf>

³ <https://www.ofgem.gov.uk/ofgem-publications/90918/dcp178letterpdfforpublishing.pdf>

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RIIO-T1” may be up to £8 billion⁴. If market participants cannot be confident that the revenue associated with this expenditure will be transparently managed, with sufficient notice of what changes to allowed expenditure will mean for revenues, this will unnecessarily increase costs to consumers.

We also do not believe that Ofgem’s needs case decision letter in July 2014⁵ provided sufficient transparency to the market on the scale of the revenue adjustment. The letter mentioned on page 8: **“Given the magnitude of the project we are considering whether to allow SHE Transmission to start recovering the revenues in 2015/16 and how this could be achieved.”** However, this is the only mention of the potential for revenue disturbance in 15/16. The letter also gives no indication of the scale of the revenues that would potentially be allowed to be recovered.

In addition, we are concerned by some aspects of the Caithness Moray consultation letter. In this it is stated specifically that: **“SHE Transmission requested we address this timing issue by updating its 2015/16 revenue in January 2015”**. As referred to previously a key element of the RIIO price control process was the expectation that effective stakeholder management would take place. We would consider that a key element of that would have been for SHETL to inform market participants of the scale and the likelihood of revenues being recovered for this project earlier than anticipated. This has not taken place and National Grid has acknowledged that these revenues have not formed part of their tariff forecasts for 2015/16.

Finally, we dispute that the apparent reduction in volatility referred to in this consultation is positive for consumers. Short notice changes cause more of an issue for market participants than volatility. If volatility is transparent efficient business planning and decision making can still take place. A lack of transparency and insufficient notice of changes reduces market confidence and contributes to the need for risk management - therefore increasing costs to consumers. It is in the interest of current and future consumers that unpredictable changes to charges are mitigated by all parties involved.

In conclusion, although we understand and are supportive of the need to reinforce transmission infrastructure the lack of transparency given along with the instability and potential future costs this will cause to market participants means we do not support the introduction of these revenues into 15/16 tariffs.

Please do not hesitate to contact me if you have any questions or queries.

Yours sincerely

Jonathan Wisdom

Network Charging Manger
RWE npower
(sent by email so unsigned)

RWE npower

2 Princes Way
Solihull
West Midlands
B91 3ES

T +44(0)121 336 5100
I www.rwenpower.com

⁴ <https://www.ofgem.gov.uk/ofgem-publications/83945/guidanceonthestategicwiderworksarrangementsinriio1.pdf>
⁵ <https://www.ofgem.gov.uk/ofgem-publications/88879/cmdraftdecisionletter22july14.pdf>

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