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1st September 2015

Consultation on our minded-to position for the review of costs associated with RIIO-GD1 enhanced physical site security uncertainty mechanisms

Dear Mick,

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 enhanced physical site security uncertainty mechanisms in the RIIO GD-1 price control. Ofgem has a critical function in reviewing costs submitted by the network owners and 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.

However, we are concerned that any additional award creates instability in revenue allowances at short notice with little to no engagement from the network owners with shippers and end consumers in informing them of likely changes to these costs.

We have two key concerns that relate to this unexpected revenue change:

- The lack of engagement from the network owners regarding these allowances prior to submitting them to Ofgem.
- The relationship to principles laid out in Ofgem's "Decision in relation to measures to mitigate network charging volatility arising from the price control settlement" document published in 2012.

Lack of Engagement From the Network Owners

Network Owners produce revenue reports highlighting when expected revenues will be recovered and what terms will change. This reporting is useful to the market and helps participants understand where costs are likely to change and why. In the Mod 186 reports published during 2015 there has been no mention of these requests for additional revenue from the network owners including in the report published in July

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around the time of the Ofgem consultation. For example National Grid Gas Distribution, in their London region, recognised only £0.2m of revenue in 2016/17 for enhanced physical site security and £0m for streetworks, however, they may now receive up to £4.8m. In addition, this information could have been communicated through this report at the time of the submissions to Ofgem in May at which point revenue reports are also published.

There are similar variances in the other network areas and other DN's reporting. This we feel breaches a key tenet of the RIIO regime in respect of stakeholder engagement and also does not provide transparency in an area of charging where clearly more can be provided. This lack of transparency means that costs have not been effectively planned for by end customers or by suppliers. In the case of customers this further increases market opacity and complexity and in the case of suppliers contributes to increased risk premia as the short term nature of these changes increases the cost risk faced by network users in the market.

Relationship to Principles Established in Ofgem's Measures to Mitigate Volatility

In October 2012 Ofgem published a decision to attempt to mitigate network charging volatility from the price control settlement.¹ We welcomed this decision and continue to support the principles it laid out. However, we consider that to effectively mitigate this element of volatility all Allowable Revenue changes should be subject to a period of notice prior to entering charging calculations. This allows the market to react and ensures best outcomes for customers.

Lack of transparency and short notice changes to revenues is a large issue that through the RIIO process seems to have been exacerbated compared to historic price control Allowed Revenue variation. If volatility is transparent and with a sufficient period of notice efficient business planning and decision making can 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 as suppliers will incorporate risk premia into contracts. It is in the interest of current and future consumers that unpredictable changes to charges are mitigated by all parties involved. Ofgem recognised in the above decision that uncertainty around revenue contributes to supplier risk and therefore inflicts additional costs on consumers. As stated in the executive summary of the decision document:

“These improvements are predominantly designed to improve the predictability of allowed revenues and therefore network charges, ie there will be a period of notice between knowing an adjustment will take place and it impacting network charges. In general, we expect our decision to result in greater certainty in relation to changes to allowed network revenues over a forward-looking two-year period.”²

At the time we welcomed Ofgem's decision to give greater certainty in the short term. We are still supportive of this principle and would welcome application of this to these proposed amendments and any further amendments as a result of incentive and cost passthrough mechanisms by ensuring revenue increases are not incorporated in the 2016/17 charging year but in a timescale reflective of the two years as mentioned above.

¹ <https://www.ofgem.gov.uk/ofgem-publications/50572/cvdecision.pdf>

² <https://www.ofgem.gov.uk/ofgem-publications/50572/cvdecision.pdf> (page 5 Executive summary)

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If you wish to discuss anything in relation to this letter then please contact me.

Yours sincerely

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