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Dear Mick,

Introduction of RIIO Accounts – further consultation on licence modification

Thank you for the opportunity to respond to the third consultation. We have responded to your specific questions in the attachment to this letter, but would also like to stress some key points as set out below.

We support Ofgem's desire to see regulated entities publish performance measures that are meaningful, clear and consistent, allowing stakeholders to easily compare performance against allowances and to reflect actual performance. If provided through a cost effective process, and constructed appropriately, we agree this initiative would provide value to both investors and other stakeholders.

Unfortunately, we believe the current RIIO Accounts proposal has significant flaws. The scope and complexity of the reporting requirements have grown substantially, increasing the regulatory burden and ultimately increasing costs to consumers. The supporting framework presents issues, with ambiguous ORFRS, absent guidance notes and lack of interpretation in key areas such as close-out mechanisms, threatening the comparability of the results being presented. As a result, we are concerned that the insistence on a 'fairly presents' audit opinion may result in a qualified audit report and risk potential licence breaches in network companies, which could ultimately undermine confidence in the framework.

Our conclusion is that we do not believe RIIO Accounts, in their current form, either represents good value for customers or meet the perceived deficiency in investor information.

We believe a significant overhaul of the proposal is needed for it to continue. The process should be simplified, with a focus on clear and comparable measures of performance. A phased implementation would also allow the supporting framework and outputs to develop over time, at a pace that satisfies the requirements of all stakeholders.

Furthermore, the requirement for information to be audited will lead to a significant increase in work and higher costs for consumers. We question the benefit of this audit requirement to consumers and suggest that unaudited reporting will meet the objectives at a lower cost.

We would recommend that any initial reporting requirements be focused solely on a selection of unaudited key regulatory measures and ratios. This would satisfy immediate investor needs, while representing good value to consumers.

Further detail on the issues associated with the implementation of RIIO Accounts

At this stage we do not believe the current format of RIIO Accounts meets the original remit for the following reasons:

1. **Investors don't want or need the information in this form.** Current investor information requirements are being satisfied by existing public and internal management reporting. The proposal, with all its complexity, means that any information being prepared is not delivered in a timely manner.
2. **Delivery of information in this format represents very poor value for money to customers.** There will be a significant audit cost to this process and an additional expensive internal resource requirement. We estimate it is likely to cost consumers and investors in excess of £4m across licensees; the consumer benefits case needs to reflect these additional costs and the audit costs in particular.
3. **Complexity of the current requirement is unhelpful.** The expected reporting requirements have grown exponentially, driven in particular by the requirement to satisfy a 'fairly presents' audit opinion. Meaningful information will be lost in the detail and the time and resource required to prepare the new regulatory accounts is now expected to be in excess of statutory reporting.
4. **Comparability of outputs across licensees.** ORFRS are ambiguous and open to interpretation. Supporting documents such as 'guidance notes for application' and worked examples (typically available for existing GAAP) are required. In addition, Ofgem need to provide explicit guidance on, or support for, opening balances and certainty around close-out mechanisms. This additional detail and support is essential to ensure the consistent application across licensees and provide comparable measures of performance.
5. **Potential licence breach.** The licence modification requires a clean 'fairly presents' audit opinion. As a result of the issues noted above, our auditors have indicated that they intend to sign-off only as "properly prepared in accordance with the ORFRS and a company methodology statement". We are concerned that requiring a 'fairly presents' audit opinion could result in a breach of licence under the current proposed licence drafting.
6. **Regulatory burden.** The reporting requirements associated with RIIO accounts are comparable to statutory accounts, requiring a full 'front-end' and methodology statement. This will be a significant increase in the regulatory reporting and place a further demand on limited resources. These requirements are well beyond that

needed by investors, for whom the timely reporting of a few key performance indicators will represent better value.

Next steps

Given the issues above, we suggest that now is an appropriate time to take a fresh look at assessing information deficiencies for all stakeholders. This will allow a clear, consistent, and efficient reporting framework to be developed.

We believe reporting on a small number of key regulatory measures will deliver this objective.

Some examples of key regulatory measures:

- i. **Totex against outputs delivered.**
- ii. **Totex against allowances.** Adjusted for enduring value.
- iii. **RoRE.** Adjusted to include all performance components, including debt, so as to provide a true reflection of performance.
- iv. **RAV.**
- v. **Cost per customer.**
- vi. **Net return to investors per customer.**

This approach would have the following benefits:

1. **It would satisfy investor information needs.** It focuses on key regulatory measures without the need for a complex and difficult to understand reporting framework.
2. **It engages stakeholders.** Information is more transparent under a simplified framework which will encourage interest and uptake.
3. **It represents good value for money.** It doesn't incur the high audit and overhead costs that the current form of RIIO Accounts certainly will.
4. **It will avoid duplication.** A simplified process would eliminate overlap and significantly enhance value with other reporting, such as the SPO.

We look forward to working constructively with Ofgem to develop an appropriate reporting framework to address stakeholder information needs. In the meantime, please do not hesitate to contact us to discuss any part of this response.

Yours sincerely

David Brocksom

CFO