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Our ref

Your ref

Date

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Dear Akshay,

## **Consultation on RIIO-2 Sector Specific Methodology**

I am writing on behalf of Western Power Distribution (South Wales) plc, Western Power Distribution (South West) plc, Western Power Distribution (East Midlands) plc and Western Power Distribution (West Midlands) plc. The attached documents set out Western Power Distribution's (WPD) full response to Ofgem's consultation of 18th December 2018 on the RIIO-2 Sector Specific Methodology.

Despite the current price control being less than half way through for electricity distribution, Ofgem acknowledges that RIIO-ED1 is delivering good outcomes for consumers. Customers are receiving the highest level of service and performance from the networks, with the number of customer interruptions falling 11% since the start of RIIO-ED1. Although we recognise there are some weaknesses in the calibration of RIIO-1 that need to be addressed, overall, RIIO-1 has been successful and looking forward, the focus for RIIO-2 should be on refinement, not fundamental change.

The current proposals from Ofgem regarding the RIIO-2 framework ignore the benefits for customers that RIIO-1 has provided. The RIIO-1 price control includes a strong incentive package which facilitates positive performance from network companies, with networks continuing to deliver for customers under this incentive regime.

It should also be remembered that the targeted improvement in performance outputs for WPD was determined in full consultation with WPD stakeholders, including full cost of delivery. This was part of the most extensive stakeholder engagement of any previous price control, which has been maintained throughout RIIO-ED1 to date.

Ofgem's proposals for RIIO-2 include a penalty heavy incentive package, with the reward for high performing companies primarily being limited to the avoidance of a penalty. In order to attract investment, it is important that companies are able to demonstrate that they will be able to deliver not only for their customers, but also that they will be able to provide predictable returns against established outcomes. The current proposals for RIIO-2 limit this considerably, with Ofgem proposing a weakened incentive package.

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The overall balance of risks, rewards and incentives needs to be considered holistically, as a price control "in the round", and hence it is important that the overall package is assessed, rather than looking at component parts in a piece-meal way, to ensure that unintended consequences do not arise.

Ofgem has contended throughout the development of the RIIO-2 price control that energy networks are low risk, and should therefore be a low return industry. However, the changing nature of the energy industry is increasing risk, as are the complex, high risk mechanisms that Ofgem is proposing in relation to Whole Systems.

Within the RIIO-2 Sector Specific Methodology consultation Ofgem has committed to reducing the price control period from eight years to five, primarily due to the changing, unpredictable nature of the energy industry in the current climate. Through highlighting the 'unpredictable nature of the energy sector', Ofgem must accept that in fact, it is not a low risk environment in which energy network companies are operating, and as such, they should be rewarded and incentivised accordingly. Ofgem is moving the industry ever closer towards developing a price control that leaves energy network companies with a real risk of becoming unfinanceable.

In our response to Ofgem's consultation on the RIIO-2 Framework, which Ofgem published on 7 March 2018, we highlighted that the current estimates of the cost of equity raise serious financeability issues and that Ofgem should revisit CEPA's analysis of the cost of equity. Ofgem has retained the same estimates, settling at the lower end of the estimate. Consequently, the same concerns remain. Ofgem must review its proposed cost of equity allowance if continued equity is to be injected and the companies are to have secure financing in the long term.

Ofgem's unilateral decision to move from six output categories to three outcome categories had the purpose of making them "as intuitive and simple as possible, reducing overlap and potential confusion." We see no clear benefit to customers from changing to the three proposed categories. Furthermore, we have no visibility of the process Ofgem followed to decide on this change.

A number of points raised in our response are supported by consultancy reports that have been commissioned by the ENA. Hence the ENA response should be read in conjunction with our submission.

As previously stated, for the RIIO-2 price control to be successful, and to mitigate possible unintended consequences, it is vital that RIIO-2 is considered in the round. Accordingly, the attached paper assesses the proposals from Ofgem's proposed RIIO-2 Sector Specific Methodology as a whole, highlighting specific areas of concern before responding directly to the specific questions contained within the main and subsidiary documents published by Ofgem as part of the consultation.

Yours sincerely,



Paul Branston  
Regulatory & Government Affairs Manager

Enc: Response to Ofgem's RIIO-2 Sector Specific Methodology Consultation Western Power Distribution