

Clothilde Cantegrel
RIO Electricity Distribution
Ofgem
9 Millbank
London SW1P 3GE

30 August 2017.

Regulatory Affairs
Ground Floor, Lakeside West
30 The Causeway
Staines
Middlesex
TW18 3BY

Dear Clothilde,

Potential RIIO-ED1 mid-period review – timetable and next steps: A call for evidence

Thank you for the opportunity to respond to the above consultation. This is a non-confidential response on behalf of the Centrica Group, excluding Centrica Storage.

We welcome the open and early engagement on the mid-period review (MPR) for the RIIO-ED1 price control. The key points of our response are:

- **The scope of the MPR, as defined in the RIIO-ED1 Strategy Decision, is clear and remains valid.**
- **A full and detailed assessment of performance in RIIO-ED1, including the drivers for out and under performance, should be provided to inform stakeholders' views.**
- **Sufficient evidence is already available to make the MPR necessary.**

Scope:

The scope of the MPR as defined in the RIIO-ED1 Strategy Decision is valid. The clarification outlined for the RIIO-T1/GD1 MPR - that there is no meaningful distinction between the introduction of new outputs and changes to existing outputs¹ - should be adopted.

Process:

The process for this MPR should be designed to encourage stakeholder engagement. Network companies publish information relating to performance but the companies and Ofgem have access to information which non-network stakeholders do not. The limited information provided in the RIIO-T1/GD1 MPR consultation² made it highly unlikely that stakeholders would be in a position to provide views on that MPR.

A comprehensive review of all aspects of the price control should be included as part of the MPR process. The review should comprise an assessment of the level of out- and under-performance, and an analysis of the drivers underlying that performance. This will allow stakeholders to assess whether any of the reasons for out- or under-performance meet the criteria for the MPR. Regardless of what issues are taken forward through the MPR, including this review of performance is important to ensure returns can be viewed as legitimate in the

¹ Decision on a mid-period review for RIIO-T1 and GD1; para 2.4:

https://www.ofgem.gov.uk/system/files/docs/2016/05/mpr_decision_document_final.pdf

² For example, the section on GD1 was less than 6 pages (including background).

eyes of stakeholders, given the expected average level of return for the sector is 9.0%³ (compared to baselines of 6.0% and 6.4%). For example, the underlying reasons why DNOs expect to under-spend expenditure allowances by £837m (3%)⁴, relatively soon after business plan submissions (following the first year of the price control), should be investigated and reviewed against the MPR criteria.

The review should be published as a part of the Phase 1 consultation in autumn 2017. Stakeholders should be allowed to propose issues they believe fall within scope to be investigated at the MPR, based on the findings of the review. Also, the comprehensive review should be made available ahead of workshops.

MPR issues:

Notwithstanding the findings of a comprehensive review, there is already clear evidence for some issues meeting the MPR criteria (both changes in government policy and the need to introduce outputs to meet consumers' needs) and so making the MPR necessary.

Clear changes in government policy:

On July 20 2017, the Government has announced the scaling down of the rail electrification programme⁵. Fast-track licensees were provided with ex-ante funding to support the electrification programme⁶. As some of the works are no longer required, the ex-ante allowances should be removed from those licensees' base expenditure allowances.

Introduction of new outputs to meet consumers' needs:

DNOs have a material role to play in the smart meter rollout programme, by carrying out certain types of activities arising from callouts. While mechanisms exist in the price control to enable DNOs to recover expenditure they incur to support the programme^{7, 8}, as there are no defined outputs, there is no mechanism for holding DNOs accountable if there is poor performance. The RIIO-ED1 Strategy Decision refers to an industry SLA being put in place regarding DNO performance in the smart rollout⁹. This implies that funding was provided on the basis of the terms of this SLA being met. This may provide a sensible start point for considering the appropriate output for the DNOs' role in the smart rollout. Ofgem should review SLA performance as part of the close out of RIIO-ED1 and defining an explicit output to support this would make it clearer.

³ RIIO-ED1 Annual Report 2015-16; para 2.22: https://www.ofgem.gov.uk/system/files/docs/2017/02/riio-ed1_annual_report_2015-16.pdf.

⁴ RIIO-ED1 Annual Report 2015-16; table 2.

⁵ <https://www.parliament.uk/business/publications/written-questions-answers-statements/written-statement/Commons/2017-07-20/HCWS85/>.

⁶ ED1 Price Control Financial Handbook (fast-track licensees); para 12A.3:

https://www.ofgem.gov.uk/system/files/docs/2017/08/ed1_handboook_v4_fasttrack_0.pdf.

⁷ ED1 Price Control Financial Handbook (fast-track licensees); para 8.1-8.7.

⁸ ED1 Price Control Financial Handbook (slow-track licensees); para 18.1-8.7:

https://www.ofgem.gov.uk/system/files/docs/2017/08/ed1_handbook_v3_slowtrack_0.pdf.

⁹ Strategy decision for the RIIO-ED1 electricity distribution price control Uncertainty mechanisms; para 3.4: https://www.ofgem.gov.uk/sites/default/files/docs/2013/02/riioed1decuncertaintymechanisms_0.pdf.

The Interruptions Incentive Scheme (IIS) also requires reviewing. Generally, targets are not set at an appropriate level, resulting in rewards of c. £647m for no improvement across the RIIO-ED1 period¹⁰. In particular, this also means that the performance for a number of networks is already beyond the level where rewards are capped and so there is no incentive for networks to improve performance in those areas¹¹. Providing an incentive to improve in this area is necessary to meet customers' needs and so reviewing these targets should form part of the MPR.

Other issues:

At RIIO ED1 Draft Determinations, Ofgem proposed a change in its Strategy Decision policy regarding some Directly Remunerated Services. The proposal was to make a 100% RAV¹² deduction for top-up and standby revenues that some DNOs treated as excluded services during DPCR5¹³. Ofgem confirmed this policy change at Final Determinations¹⁴. We would welcome confirmation that the same necessary RAV deductions have been made to fast-track licensees.

Ofgem has recently decided to approve a modification that changes the funding arrangements for providing support to the process of developing the electricity distribution charging methodology¹⁵. This is fully funded through the existing RIIO-ED1 allowances. This will now be changed to be also funded across all DCUSA parties. If RIIO-ED1 allowances are not adjusted, DNOs will now benefit, at the expense of customers, through the efficiency incentive. Efficiency rewards should be earned through delivering outputs at a cheaper cost to the customer and not through industry modification (particularly ones that place *additional* costs on customers). Ofgem should seek to rectify this. It is an important principle that efficiency rewards need to be earned.

We hope you find these comments helpful. Please do not hesitate to contact me if you have any questions.

Yours sincerely,

Andy Manning
Director - Network Regulation, Forecasting and Settlements

¹⁰ £647m (2012/13 prices) across RIIO-ED1 if CI/CML performance is held at levels achieved in 2014/15.

¹¹ In the first year of RIIO ED1 five networks achieved performance beyond the level where rewards are capped.

¹² Regulatory Asset Value.

¹³ RIIO-ED1: Draft determinations for the slow-track electricity distribution companies Overview; paras 5.39-5.44:

https://www.ofgem.gov.uk/sites/default/files/docs/2014/07/riio_ed1_draft_determination_overview_30072014.pdf.

¹⁴ RIIO-ED1: Final determinations for the slow-track electricity distribution companies: Overview; para 5.42

¹⁵ Distribution Connection and Use of System Agreement (DCUSA) DCP289/289A/289B – Creation of Distribution Charging Methodology Development Group:

https://www.ofgem.gov.uk/system/files/docs/2017/08/dcp289_d.pdf.