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29 January 2021.

Sent by email to: Kelvin.Hui@Ofgem.gov.uk

Dear Kelvin,

Price Control Deliverable Reporting Requirements and Methodology Document

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

Price control deliverables (PCDs), which allow expenditure allowances to be aligned with delivery, are a welcome introduction into the RIIO framework. The implementation of PCDs addresses gaps in the RIIO-1 price controls in which allowances could not have been adjusted due to changing circumstances because some expenditure allowances were not explicitly tied to outputs. For example, consumers not being required to fund £480m of investment not needed relied on National Grid Electricity Transmission voluntarily returning 'non-variant' allowances[1]. The implementation of PCDs will allow companies to be better held accountable for outputs they received funding to deliver.

Funding adjustments:

It is necessary to ensure mechanisms in the guidance do not lead to poor value for consumers. In *Hypothetical Example 3* (partial delivery with cost savings), Ofgem would adjust expenditure allowances downwards to £160m of the £200m provided up-front even though the company would have spent only £20m to deliver what would be deemed to be 80% of the output. The source(s) of variance to ex-ante allowances would need to be thoroughly investigated given ex-ante allowances would have been provided on the basis there was sufficient certainty about the need for and the level of investment.

We note ex-ante allowances would be 'reset' to 800% of the expenditure incurred. This comprises actual expenditure and up to 50% of un-spent allowances to be retained by the company, resulting in consumers being required to fund between 331% and 450% of actual expenditure via the Totex

[1] See: https://www.ofgem.gov.uk/system/files/docs/2017/06/nget480_open_letter_final_0.pdf.

Incentive Mechanism (TIM)[2]. This is disproportionate, especially given it would have been deemed there was sufficient certainty of the level of investment needed at the price control review in order to provide ex-ante allowances. We believe it is inappropriate to use the TIM in these circumstances. The TIM is to give incentive rewards for efficient delivery and not for rewarding delivering in a different way than assumed when setting allowances. This should be rewarded, but in a more proportionate manner, either by a reduced sharing factor or by applying a margin on top of costs. The example also highlights that careful consideration needs to be given to how delivery is assessed and also the parameter against which delivery is assessed, as discussed in paragraph 5.9. This is needed to ensure funding adjustments are efficient from the consumer perspective, taking into account the impact of the TIM.

Delay or non-delivery:
In paragraph 4.2, it is explained Ofgem will assign project statuses, including for scenarios in which a company has not delivered the PCD by the specified delivery date but intends to do so at a later date (delay) or not at all (non-delivery). Those decisions may be beneficial for consumers. It is therefore necessary to ensure the guidance does not discourage delaying (or not delivering) projects, when that is the right decision for consumers. To avoid ex-post funding adjustments being made, a company may have an incentive to invest to deliver an output in full, even though partial delivery or not undertaking the investment is more efficient from the consumer perspective. If a company can deliver an output for less than the allowance, the efficiency reward means the company would be better off than not delivering the project (and losing the allowances). Consumers would then be required to fund the investment despite it being sub-optimal. Mechanisms within the RIIO-2 price controls should be designed to encourage companies to always make decisions that are efficient from the consumer perspective. In this scenario, it may be appropriate for companies to receive some reward for scaling back or cancelling investment.

We hope you find these comments helpful. Please contact me if you have any questions.

Yours sincerely,

Andy Manning
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[2] The range is derived from the sharing factors for the RIIO-2 transmission and gas distribution price controls. See paragraph 10.2 of “RIIO-2 Final Determinations - Core Document”.