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Sent by email to: Graham.Craig@ofgem.gov.uk

Dear Graham,

RIIO-2 Re-opener Guidance and Application Requirements Document

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

We welcome the guidance, which is intended to introduce more rigour into the process for in-period adjustments. Companies should take as rigorous an approach to applications during re-opener windows as for funding proposals submitted during price control reviews. Our view is informed by our experience of re-openers during the RIIO-1 period. For example, during the 2019 window for electricity distribution, one of two 'Rail Electrification' applications was rejected because it did not comply with requirements¹. All four 'High Value Projects' applications were rejected because they did not comply with requirements and/or the efficiency of the proposals was not demonstrated².

A clear disincentive to making speculative applications is required. Re-opener mechanisms should not be seen as a 'free bet' to increase expenditure allowances. Companies should demonstrate the efficiency of their proposals from the consumer perspective, taking account of the expenditure allowances consumers will be required to fund via the Totex Incentive Mechanism. Also, applications should be thoroughly scrutinised. Therefore, we believe the proposed fast-track framework should be tightened. Other improvements to the guidance should also be considered.

The proposed fast-track framework should be tightened:

We acknowledge the intent to design the re-opener process to be agile since, relative to RIIO-1, a greater number of re-opener mechanisms is included and a greater number of applications is expected. In principle, we support the intent and we recognise this is a reason why 'lighter touch'

¹ "RIIO-ED1 Reopener Decision – Rail Electrification Costs"; paragraph 3.9.

² "RIIO-ED1 Reopener Consultation – High Value Projects"; sections 2 – 5.

assessments are proposed. However, the efficiency of all applications from the consumer perspective should be thoroughly tested - at least the standard level of regulatory scrutiny should apply. This is necessary given that up to £10bn of expenditure allowances could be provided to the transmission and gas distribution companies via uncertainty mechanisms (including re-openers)³. This means the proposed fast-track framework should therefore be tightened.

'Lighter touch' assessments may not always deliver long-term consumer value. A recent example of 'lighter touch' assessments is 'fast-tracking' at the RIIO-1 price control reviews. In its review of the RIIO arrangements, CEPA state the cost of Western Power Distribution being 'fast-tracked' during the RIIO-ED1 price control review is £510m of increased revenue⁴. The benefits are less clear-cut. Further, CEPA was unable to establish whether 'fast-tracking' in the transmission price controls delivered consumer value. The broad approach that underpinned 'fast-tracking' in RIIO-1 is not dissimilar to that proposed in the guidance.

Similarly, it is unclear whether the four 'High Value Projects' applications submitted during 2019 window for electricity distribution would have been assessed as inefficient had 'lighter touch' arrangements existed. If they were approved, consumers would have been required to fund £177m of expenditure allowances.

It is unclear whether the 'lighter touch' assessments proposed can robustly identify inefficiency. As such, we recommend:

- The efficiency of all applications from the consumer perspective should be thoroughly tested regardless of the initial perceptions of the quality of the evidence provided by the companies.
- The efficiency of all applications from the consumer perspective should be thoroughly tested even if there is a substantial benefit or if the decision is not complex.
- It may be appropriate to take a 'lighter touch' approach to the Needs Case stage if one was previously established and circumstances have not materially changed since.

These improvements are necessary to avoid consumer value being lost due to insufficient level of scrutiny.

Other improvements:

Coordinated Adjustment Mechanism re-opener application guidance:

- On page 26 of the guidance, it is proposed payments to other companies for compensation do not need to be included in cost benefit analyses (CBAs). Every project should be assessed from the consumer perspective, which should include all costs that consumers will be required to fund. As such, payments to other companies for compensation may be excluded only if consumers will not be required to fund them.
- On page 26 of the guidance, it is proposed a cross-sector project should be demonstrated to provide a net benefit to both electricity and gas consumers. It is possible a cross-sector project could provide an overall net benefit to energy (electricity and gas) consumers while resulting in a dis-benefit to those in one sector. Provided there is no legal impediment, we recommend this requirement is relaxed, so that projects of this type could be progressed.

³ "RIIO-2 Final Determinations - Core Document"; paragraph 1.2.

⁴ "Review of the RIIO Framework and RIIO-1 Performance"; page 64.

Rejection of non-compliant applications:

It is proposed that an application not in accordance with any of the relevant requirements may be rejected. We expect this is intended to deter companies from submitting applications that do not comply with all requirements. We agree companies should be discouraged from submitting non-compliant applications but are concerned this may result in consumer dis-benefit. Investment which could deliver consumer value may be delayed or cancelled. Instead, we recommend companies are financially penalised if applications are non-compliant; this may be a more effective deterrent.

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

Yours sincerely,

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