

RIIO-GD3 Draft Determination Consultation Response

WWU Annex

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WWU Annex Response

BPI Questions

WWUQ1. Do you agree with our view that WWU passed all of the minimum requirements and as such are considered to have passed Stage A of the BPI?

Yes

WWUQ2. Do you agree with our assessment results for WWU against Stage B of the BPI?

No.

We provide in our own response and in appending documents a significant number of challenges and improvements to the Stage B assessment, in addition to material errors within the cost assessment process. These corrections must be applied and stage B reassessed before meaningful comment can be provided on the assessment.

Stage B of the Business Plan Incentive (BPI) is the most financially significant component, designed to reward gas distribution networks (GDNs) for submitting cost-efficient and deliverable business plans.

We have concerns and have undertaken additional analysis to demonstrate that the assessment places over emphasis on cost ambition and rewards ambitious cost forecasts, even if they lack deliverability or a historic track record. Coupled with this there is no direct penalty for over-optimism or failure to deliver forecasted efficiencies. This creates a misalignment between ex ante ambition and ex post accountability. We also observe a lack of integration with Service Quality, which distorts the value that is delivered and masks poor performance. The assessment of Stage B rewards demonstrates how Ofgem has inadvertently decoupled cost assessment from service quality performance, despite a stated goal of incentivising value for money.

Unlike the RIIO-GD1 IQI mechanism, Stage B does not adjust the TOTEX Incentive Mechanism (TIM) based on business plan ambition. This weakens the incentive for networks to submit realistic and deliverable plans.

Stage B is mechanistic, and the rewards should be commensurate with the value delivered and confidence in delivering following Ofgem's cost assessment process.

Our appended report, prepared by Oxera provides a comprehensive overview of the performance of GDNs on both cost efficiency and services performance, specifically section 4 of the report and Figures 4.2-4.7 present GDN performance from a cost and service perspective, this must be taken account of to ensure incentives and rewards are in the interest of consumers.

WWUQ3. Do you agree with our assessment results for WWU against Stage C of the BPI?

Overall, we consider the Stage C assessment is subjective and Ofgem must apply it consistently to derive value from the business plans. Stage C of the Business Plan Incentive (BPI) comprises two components:

- Clarity: Evaluates the structure, accessibility, and coherence of the business plan.
- Commitments: Assesses the ambition of service offerings across net zero, resilience, and service quality.

Having reviewed the draft determinations, NGN commissioned Oxera to review the BPI incentives¹ and they found that stage C had:

- Limited Incentive Strength: The maximum reward for outstanding service quality performance is 13 basis points (bps), significantly lower than the 40bps available for cost efficiency under Stage B.
- Balanced Scorecard Dilution: Rewards are further diluted through a scorecard approach, with equal weightings across four criteria (deliverability, consumer value, stretching performance, and new proposals).
- Skewed Incentive Architecture: The current framework heavily favours cost reduction over service quality, both ex ante (during plan submission) and ex post (during delivery).

In relation to WWU's plan we note the subjectivity of the assessment in the round on clarity and conflict of assessment between ratings of outstanding versus poor.

Additionally, we note that WWU has historically delivered high levels of service consistent with their regulatory contract, despite cost challenges that have increased their cost base. Where other networks performance has slipped, WWU has maintained a position close to the frontier indicating they do not compromise on service objectives. This doesn't appear to be accounted for in Ofgem's assessment. We reference our appended report, prepared by Oxera, provides a comprehensive overview of the performance of GDNs on both cost efficiency and services performance, specifically section 4 of the report and Figures 4.2-4.7 present GDN performance from a cost and service perspective. Similar to Ofgem's approach to engineering justification analysis we consider significant weight should be placed on delivered past performance when assessing anticipated performance and notably:

1. Ofgem should not be seen to be rewarding companies at RIIO-GD3 FD who have failed significant service standards in RIIO-GD2.
2. Ofgem must be consistent in how they assess commitments at the group and network level to avoid masking or rewarding poor performance.
3. A sufficient incentive for under delivery or poor performance must be explored.

This is particularly important given parallels with shortcomings observed in Ofwat's cost and service assessment practices since PR14, where over-reliance on optimistic forecasts created *perverse incentives* of chasing business plan rewards and left companies unable to invest adequately to maintain and improve service levels. A similar approach here would risk rewarding networks that failed to meet core service standards in RIIO-GD2, such as the 1- and 2-hour gas emergency standard. That outcome would be unfair to consumers and damaging to Ofgem's credibility if it were to reward companies who failed these core service standards or those with significant overspend in RIIO-GD2 but are now benchmarked favourably, noting this issue has significant implications at both the group and network level. Such an approach would be contrary to Ofgem's principal objective to protect the interests of existing and future consumers. Effective regulation requires that incentives and rewards are tied to demonstrable performance against required standards, which in turn ensures trust in the framework and supports desirable outcomes for consumers over the long term.

¹ BPI Incentives at the RIIO3 DD

We note the ambitious plans that were submitted at RIIO-GD2 and suggest Ofgem sense check how companies have performed in delivering against those outcomes and consider the actual delivered evidence on costs and performance commitments before finalising its Stage C assessment.

Managing Uncertainty Question

WWUQ4. Do you agree that WWU's Prepare the business for a net zero future proposal, in its current form, should not be eligible for NZARD UIOLI funding?

Yes

We acknowledge Ofgem's position on a £2m cap for NZARD UIOLI projects, which excludes this project, and support the necessary scope to be developed within WWU NZARD and added to the pipeline of projects for funding under NZASP reopener.

We consider that Ofgem should work with networks to develop processes to expedite assessment and approval of NZASP projects in RIIO-GD3.

WWUQ5. Do you agree that WWU's Facilitate green gases proposal, in its current form, should not be eligible for NZARD UIOLI funding?

Yes

We acknowledge Ofgem's position on a £2m cap for NZARD UIOLI projects, which excludes this project, and support the necessary scope to be developed within WWU NZARD and added to the pipeline of projects for funding under NZASP reopener.

We consider that Ofgem should work with networks to develop processes to expedite assessment and approval of NZASP projects in RIIO-GD3.

WWUQ6. Do you agree that WWU's Move towards an ultra-low emission fleet proposal should not be eligible for NZARD UIOLI funding?

Yes

We acknowledge Ofgem's position on a £2m cap for NZARD UIOLI projects, which excludes this project, and support the necessary scope to be developed within WWU NZARD and added to the pipeline of projects for funding under NZASP reopener.

We consider that Ofgem should work with networks to develop processes to expedite assessment and approval of NZASP projects in RIIO-GD3.

WWUQ7. Do you agree that WWU's Improve energy system planning proposal should not be eligible for NZARD UIOLI funding?

Yes

We acknowledge Ofgem's position on a £2m cap for NZARD UIOLI projects, which excludes this project, and support the necessary scope to be developed within WWU NZARD and added to the pipeline of projects for funding under NZASP reopener.

We consider that Ofgem should work with networks to develop processes to expedite assessment and approval of NZASP projects in RIIO-GD3.

Cost of Service Question

WWUQ8. Do you agree with our engineering assessment of WWU's RIIO-3 Business Plan?

We don't have the full detail or understanding of the risk position of WWU's asset base to fully answer this question. However, we consider that WWU, must be provided with sufficient allowances to ensure that they meet health and safety, security of supply and customer outcomes at an efficient cost, taking account of their historic delivered performance. We note that customers should not pay twice for work that has already been funded in previous price controls.

Innovation Question

WWUQ9. Do you agree with the level of proposed NIA funding for WWU?

No.

We reaffirm that projects to prepare gas networks for future net zero scenarios and the energy transition should be included within NIA funding, as there is significant work to prepare companies regardless of the project. NGN provides significant detail on this in its own response.

We note that the WWU NIA allowance has been cut significantly from its business plan proposal and this should be reconsidered as there are several valuable projects that could be progressed at a network or industry level to instil valuable learning that is in the interest of consumers.

Historically, Innovation funding, consistent with other allowances has been roughly apportioned on a network/revenue basis to account for the customer base but to ensure parity on progressing valuable research and development. WWU has always been a valuable contributor and collaborator to these projects. If they do not have sufficient allowances, then their ability to contribute is diminished and this would be to the detriment of consumer interest.

For projects where there is valuable industry learning we suggest a formalised collaborative approach where all networks fund projects on a 4:2:1:1 split for the benefit of consumers. There are several projects WWU propose that would best serve the industry and not networks own ambitions. NIA should facilitate wider learning as Ofgem outlines. This would help bridge the gap between WWU allowance, minimise cost to consumers and deliver wider benefit.

Data & Digitalisation Question

WWUQ10. Do you agree with our proposed level of funding for WWU data and digitalisation investments?

No comments