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Michael Smith
Ofgem

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Dear Michael,

Citizens Advice welcomes the opportunity to respond to Ofgem's Statutory Consultation to modify the Price Control Financial Instruments and Licence conditions for Gas Transmission, Gas Distribution and Electricity Transmission. We are responding as part of our statutory role to represent energy consumers in Great Britain and will be focusing our response on the proposed modifications to the Fuel Poor Network Extension Scheme (FPNES) volume driver and Vulnerability and Carbon Monoxide Allowance (VCMA) (special conditions 3.14 and 5.4 respectively).

We support the first decision to adjust the allowances available for the Fuel Poor Network Extension Scheme. Appropriate levels of funding should remain available for fuel poor households who could see lower bills from connecting to the gas grid. We agree that it is also in consumers interests to wind down the scheme due to the lower than expected demand and the conflict with low carbon policies.

Methodology

We recognise that reducing FPNES allowances prompts the question of what to do with the unused allowances. The primary option that we consider to be typical in price controls is to return all the funding back to customers in recognition that the allowances will no longer be spent in the way assumed in the business planning process and as specified in Ofgem's Final Determinations.

Ofgem proposes to take a different option which is to amend the licence conditions to reduce the allowances for the FPNES and increase allowances for the VCMA by the same amount. We remain concerned that Ofgem's methodology uses the maximum volume driver as a starting point for these calculations, which we do not believe is appropriate as we have raised previously with Ofgem. These were set at an average of three and a half times (254%) higher than the ODI-R targets which themselves are unachievable. At its most extreme, one licensee's max volume driver target is more than 7 times their ODI-R target. We believe the targets and the size of the allowances to meet the maximum volume driver specified in Final Determinations have been demonstrated to be excessively high. They are therefore no longer relevant and are an arbitrary driver for repurposing allowances, other than to keep GDNs' total allowances unchanged overall which Ofgem do not state is an explicit aim of this process.

Ofgem's use of the maximum volume driver to allow for 'flexibility in over-delivery' amounts in an additional £111 million of available funding for the VCMA. This is a vast increase in funding, increasing from £60 million to £171 million. Assuming the money will no longer be available after the end of the GD2 price control in 2026, it may also need to be spent at pace[1]. This sum of money has not been sized according to demand or specific business plan proposals, as would be more typical in a price control as demonstrated by ED2 where approximately £70 million of allowances have been agreed at Final Determinations based on a lengthy process of business planning and stakeholder engagement.

We believe a more transparent process is to size FPNES allowances according to what is anticipated to be needed per licence area and for remaining allowances to be pooled. Ofgem should then require GDNs to submit costed strategies and commitments for how any increased VCMA allowances would be spent with Ofgem taking decisions on the appropriate level of allowances to be provided, returning anything else to customers.

Timeline and risks

As mentioned above, the vast majority of the total £171 million of VCMA allowances proposed by Ofgem has relatively little time in which it can be spent, assuming the money will no longer be available after the end of the GD2 price control in 2026.

[1] We recognise that there is potential for this to be extended to 2028, however, this will not be known for some time.

Funding must remain sustainable for partners delivering VCMA projects, the majority of whom are charities, and to avoid flooding local charities and the advice sector with short-term funding that may not be available again in future price controls. We have highlighted in a previous paper the issues caused by a short term, insecure and piecemeal funding landscape for advice which we think requires a clearer strategy.[2]

We recommend that Ofgem requires explicit consideration of this from GDNs in establishing new strategies and includes a new obligation in the guidance that requires GDNs to set out how funding sustainability challenges have been considered in projects.

Scrutiny

We agree with Ofgem that an increase in spend of over £100 million should come with more scrutiny into GDNs' plans and greater focus on the impact of VCMA projects. This rise in available funding puts the total vulnerability spend for GDNs at more than double that of the c.£70 million given to DNOs to spend over five years in ED2. However, while funding for DNOs is underpinned by a financial incentive and a specific business plan commitment reporting regime, GDN funding is still only predicated on a reputational incentive.

As a first step, we believe that Ofgem should conduct an interim audit of spending to date, with a particular focus on whether PEA submissions meet the existing requirements. This would provide valuable learning for how to improve eligibility criteria and governance arrangements.

Ofgem should also consider the value of the GDN showcase event: it must be structured and robust to ensure it acts as a proper incentive for the GDNs, otherwise it should be removed. As we recommended to Ofgem in its first drafting of the VCMA guidance, a price control Open Hearings format is a better model to follow. We would expect Ofgem to sign off on strategies that contain specific projects and targets with any money spent poorly being recovered from GDNs.

The current ENA innovation project on standardising a methodology for calculating SROI will publish its findings too late for the initial allocation of the additional funding, but in subsequent years Ofgem could use this opportunity to set a minimum level of SROI for projects, rather than just requiring the level to be positive.

[2] Citizens Advice, Tackling gaps and overlaps: a discussion paper addressing the energy advice challenge, April 2022

It is also essential that Ofgem requires strategies and reporting to be standardised, to ensure that information is consistently presented. This will aid ongoing scrutiny by Ofgem as well as stakeholders as inconsistency significantly weakens any reputational incentive. In particular, there must be significantly improved reporting on progress against business plan commitments already made as well as commitments made in new strategies for VCMA spend.

Eligibility criteria

Ofgem should consider updating guidance around the way GDNs should spend VCMA funding. Firstly, it must ensure that money is primarily spent to help those in fuel poverty and as a response to the cost of living crisis, to align with the original purpose of the FPNES. The governance should therefore specify a minimum proportion of spend for fuel poverty projects.

We would also urge Ofgem to ensure project eligibility criteria ensures maximum social impact from projects, and increases the minimum proportion required for collaborative spend. We would like to see collaboration feature more heavily across GDN areas and also involve DNOs where appropriate to prevent any duplication of effort and of procurement processes.

We believe it is in consumers' interests that spending is focussed on providing support. Spending for administrative purposes should not be permitted from VCMA funds (or at least highly limited). Also, the consequential impact of additional VCMA funding on returns to the company should be recognised. It is our understanding that additional VCMA funding will increase regulatory asset values and so will translate to additional returns for the companies[3].

We also remain of the view that it is outside of the networks' role to be undertaking energy efficiency work and that this is an aspect of the eligibility criteria that should not be altered.

Implementation

We recognise that Ofgem has intended to move quickly, however we do not think that the approximately 8 week process given to GDNs to develop strategies on how to spend £111 million of allowances in 3 years is proportionate. As the licence condition change in question is wrapped up in a package of other changes, Ofgem should publicly make

[3] We estimate this to be in the order of £20 million, depending on the exact regulatory treatment

clear its expectations in the form of an open letter. This should include that strategies should be adequately robust with Ofgem sign off and that the appropriate scrutiny and governance is in place before new spend is permitted.

Yours sincerely,

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