

RIIO-ED2 Methodology Consultation Response

5th October 2020

About Energy UK

Energy UK is the trade association for the energy industry with over 100 members spanning every aspect of the energy sector – from established FTSE 100 companies right through to new, growing suppliers and generators, which now make up over half of our membership.

We represent the diverse nature of the UK's energy industry with our members delivering almost all (90%) of both the UK's power generation and energy supply for over 27 million UK homes as well as businesses.

The energy industry invests over £13.1bn annually, delivers around £85.6bn in economic activity through its supply chain and interaction with other sectors, and supports over 764,000 jobs in every corner of the country.

Executive Summary

Energy UK welcomes the opportunity to respond to Ofgem's consultation on its RIIO-ED2 methodologies. We welcome the ambition for efficiency and reducing the cost to the consumer that these draft determinations have presented. Energy UK further welcomes the engagement approach including the use of Working Groups to develop determinations within RIIO-ED2. There remains a need for wider engagement outside of these groups within the remaining process, as each of those groups should be testing their positions with a range of industry stakeholders.

Energy UK welcomes the ambition and efficiency stretch implicit in the RIIO-2 Draft Determination and ED2 Methodology. These consultations demonstrate a clear aim to ensure that the appropriate investment is facilitated in the networks, whilst also ensuring that bill payers are paying a fair amount for the service. We do, however expect this to be balanced in approach that should not stretch beyond what is reasonably workable for the networks.

It is essential that all RIIO-2 determinations facilitate the net-zero transition. Given the nature of decarbonisation pathways for the UK, RIIO-ED2 will be a critical part of not only further decarbonisation of power, but also of heat, transport and industry. RIIO-ED2 must incentivise the use of markets for flexibility, while also giving the network companies the ability to adequately invest in networks to maintain a proper level of resilience and security of supply.

This includes the need to address network monitoring, data and digitalisation requirements to give transparency over network decisions and allow for market solutions to be provided. Without far greater access to granular information about the state of the network, flexibility markets will not develop fully.

Network companies' participation in ancillary services

Network companies are responsible for assessing their network needs; proposing the appropriate reinforcements; and using the data relating to network needs to tailor and re-design solutions.

Some distribution and transmission networks have indicated their expectation to bring to market assets to participate in competitively procured ancillary services. We would like to reiterate Energy UK's position strongly against the participation of network companies in competitively procured ancillary services as it allows network companies to leverage their unique position to compete in ancillary services using network assets; this departs from the level playing field of undistorted competition. Furthermore, in the context of the provision of

ancillary services through pathfinders, we are keen to better understand how the ESO is expected to effectively assess potential service providers when it does not have full regulatory oversight.

We have outlined some of our views in our response to *“Regulatory treatment of CLASS as a balancing service in RIIO-ED2 network price control”* and, as always, we would welcome further discussions with Ofgem to outline our views and concerns.

Energy UK would welcome any questions or further discussion on these points. I can confirm that there is no confidential information in this response, and as such it can be published.

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Energy UK responses to consultation questions

OVQ1: Do you have any views on our proposal to include a statement of policy in Final Determinations that in appropriate circumstances, we will carry out a post appeals review and potentially revisit wider aspects of RIIO-2 in the event of a successful appeal to the CMA that had material knock on consequences for the price control settlement?

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OVQ2. Do you have any views on the proposed pre-action correspondence, including on the proposed timing for sending such to Ofgem?

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Net Zero and Innovation

OVQ3. Do you agree with our proposed approach to a Net Zero re-opener?

Yes. Energy UK agrees that activities during the RIIO2 period will have a significant role to play in preparing the network companies for net zero challenges, but also that many of these activities are awaiting policy certainty. A net zero re-opener is therefore an appropriate mechanism for electricity distribution networks to ensure that they are ready to support the step change in deployment of electric vehicles, electrification of heat and decentralised energy resources.

In order to foster confidence in the Uncertainty Mechanisms from both network owners and investors, we encourage Ofgem to provide timeframes for decision upon triggering an Uncertainty Mechanism. It may also be suitable to provide network owners with a guidance on how to support Ofgem decisions with relevant and granular information to assess an Uncertainty Mechanism request quickly and appropriately.

Energy UK understands the need for reopeners where the needs case or options are not yet fully established and for a review mechanism to ensure best value for customers. However, there is a balance to be struck between best value for customers (customers not over paying, as may occur if allowances were included in baseline and spend outturns lower than the allowance) and predictability and certainty of charges.

The shift in revenue from baseline funding to reopeners increases the unpredictability of charges faced by customers so any changes must be signalled well in advance and not only flagged as allowed revenue changes. We request that indicative charges effective to the remainder of the price control period are published as part of the stakeholder consultation. Adequate lead-times are required to ensure network charges are efficiently reflected in customer tariffs.

Energy UK would also like to understand whether Ofgem is adequately resourced to progress multiple reopeners in parallel, we would not like to see important projects face delay. Decisions on reopeners must not be allowed to delay decisions on investment for infrastructure necessary for net-zero. This leads us to explore whether aligning reopener submissions at a single point in the year and at certain defined points across the price control period is the best approach. Submission based on project requirements and/or an annual process may be more appropriate for delivered the best consumer outcomes at least cost.

Our experience of reopeners in RIIO1 has been that the combination of information asymmetry and opacity of the process made industry engagement at a meaningful level challenging. The potential volume and importance of RIIO2 reopeners is therefore of concern to Energy UK.

Resourcing is an issue for industry parties, and should be considered. The consequences in terms of efficiency and cost on the entire industry, in particular the network companies, of holding constant or a series of price reviews should be considered by Ofgem.

Strategic Investment for Net Zero

OVQ4: In what circumstances, would a centralised approach to setting forecasted outputs be appropriate? What form should this take?

Ensuring that any geographical variation results in efficient investment ahead of need will be dependent on two broad factors:

- Prioritising the development of effective markets for flexibility to maximise use of the existing and developing flexible resources.
- The application of centralised and standardised forecasting parameters to ensure a common approach is applied across all distribution network areas.

We note that many network owners and operators have developed their own pathways or plans to achieve net-zero targets, as have local authorities across the UK. While these should factor into the forecasting approach taken by networks, it is important that any investments are aligned with a single strategic framework delivering consistency across the network companies, overseen by Ofgem.

A wholesale reliance on centralised approach to setting forecasted outputs will only continue to be appropriate if government is willing to set more granular targets for all elements of decarbonisation. At present, anticipating uptake of LCTs accurately would require considerable analysis of a range of factors that Ofgem cannot reasonably be expected to have full sight of.

Ofgem should, however, continue applying a single centralised approach to setting forecasting parameters to set the broad direction of travel within which local and regional factors can be integrated. Ofgem should also be setting the parameters and methodology for any allowable deviation, to ensure that all DNOs are setting forecasted outcomes based on the same assumptions and processes. This will allow for a centralised framework to be applied to regional approaches to forecasted outputs.

OVQ5. What would be the factors we should take into account that would give us high certainty in a centralised approach to setting outputs?

Arguably the most impactful factors for decarbonisation will be factors established by Ofgem and the Government. The Government setting granular targets for decarbonisation and Ofgem establishing a framework under which industry can deliver against these targets will heavily impact the certainty of established outputs.

The Government setting targets for EV uptake and heat decarbonisation in its upcoming Transport Strategy and Heat and Buildings Strategy will impact industry investment and focus, as well as driving up consumer demand. Ofgem developing appropriate price signals through the development of more effective markets for flexibility and the delivery of Access and Charging reforms will help to make the business case for investment in flexible assets.

Economic impacts of COVID-19 and the UK's exit from the European Union will further impact the ability of consumers to adopt LCTs and the ability of industry to source low cost investment for grid-scale assets. This uncertainty must be factored into the approach.

OVQ6. Alternatively, in what circumstances would it be more appropriate to take a decentralised approach to determining forecasts?

Given the time-frame of RIIO-ED2, Energy UK supports some decentralisation of determining forecasts, but only within a transparent framework set by Ofgem, as set out in response to Q4.

OVQ7. What would be the factors that we should take into account that would give us high certainty in forecasted outputs derived through a decentralised approach?

A wide range of variables exist for any decentralised approach, including but not limited to:

- Local Area Energy Plans / Local authorities' ambitions.
- Socio-economic circumstances of the local population.
- Existing network capacity and asset health – requiring much more granular visibility of LV networks.

Establishing a framework for LAEP Best Practice will give more certainty, and the role of the networks will remain in enabling and supporting decarbonisation, rather than actively pursuing it.

OVQ8. Do you consider that the LAEP Best Practice guidance produced by the Centre for Sustainable Energy and the Energy Systems Catapult provides adequate checks and balances to ensure that local or regional energy plans are robust, unbiased and have broad support?

Yes, Energy UK supports the implementation of an LAEP approach along the lines of that approach. This will require further consideration and consultation to ensure appropriate consideration of all unintended consequences and factors.

OVQ9. Which of the uncertainty mechanisms and incentives in Appendix 3 will be most effective in enabling efficient strategic investment?

Energy UK does not hold a single preference, it welcomes the recognition in this section of the RIIO consultation that the networks should install monitoring on parts of the network that are constrained or may become constrained. However, this needs to go further as monitoring equipment and the data gathered from the infrastructure will be critical to developing a functioning and complete flexibility that all customers can participate in. There is a clear need for increased visibility across DNOs about how much of an increase in demand the existing network can accommodate.

Data that would help in increasing the availability of flexibility include:

- real time management of feeder capacity
- real time feeder headroom / footroom
- substation voltage
- asset health indexes
- losses recorded at substation level
- regional / local RoCoF,
- Up-to-date data on flexible capacities connected to the feeder.

DNOs can minimise uncertainty by gathering and making publicly available information on current levels of network utilisation and changes to utilisation based on different forecast growth scenarios. Flexibility cannot be utilized if DNOs do not make available information about which area is constrained or will be constrained.

All of the uncertainty mechanisms should fully utilise this range of data to create a holistic and more accurate understanding of the changing needs of any network area.

Innovation

OVQ10. Do you agree with our proposals to increase levels of BAU innovation?

Energy UK broadly welcomes the proposals to integrate innovation further into BAU across DNOs, as this is critical to moving beyond projects being run in separate silos and deliver wholesale modernisation across the GB energy network. Energy UK would, however, note once again the importance of consulting on implementation of any considerable change to BAU beforehand.

The application of technology developed in an innovation project known as Project CLASS is one such innovation that should have seen full consultation before implementation, given the fundamental shift in the nature of network assets. If Ofgem's integration of innovation in BAU is not carefully managed, other approaches being implemented may cause further detriment to the development of appropriate price signals and incentives for flexibility.

The RIIO-ED2 Challenge Group should be given the ability to hold up certain DNOs' implementation of innovation as BAU and challenge others as to why they have not rolled out similar works. For example, where monitoring capabilities are improved thanks to a low cost solution rolled out in one network area, others should be challenged as to why they are not applying the same approach.

OVQ11. Do you agree with our proposed methodology in relation to the RIIO-2 Strategic Innovation Fund?

Energy UK broadly agrees with this proposal and awaits the full specific consultation for any further detail.

OVQ12. Do you agree we should adopt a consistent NIA framework for DNOs, and other network companies and the ESO?

Yes.

OVQ13. What are your thoughts on our proposals to strengthen the RIIO-ED2 NIA framework?

Energy UK broadly agrees with the proposals.

OVQ14. Do you have any additional suggestions for quality assurance measures that we could introduce to ensure the robustness of RIIO-2 NIA projects?

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OVQ15. Do you agree with our proposed approach for setting individual levels of NIA funding?

Energy UK broadly agrees with the approach.

Modernising Energy Data

OVQ16. Do you agree with our approach to regulating digitalisation and better use of data through the introduction of cross-sector licence obligations?

Energy UK welcomes the continued focus on data and digitalisation from Ofgem, and the approach set out in this consultation seems sensible. Ofgem should ensure that there are codified points at which it will review the progress made across all networks to analyse 'what good looks like' and ensure standardised approaches across all network areas.

DSO transition

OVQ17. Do you agree with the proposals we have set out to support optionality for wider institutional change should we later decide to separate DSO functions from DNOs? How else could the methodology support optionality?

Energy UK welcomes the efforts taken to retain optionality, but would note that many industry parties will feel that incorporating DSO functions into the RIIO-ED price control is not appropriate. It seems counter-intuitive to wish to keep optionality available while integrating incentives for DSO functions into a price control only applicable to DNOs. This being said, the DSO functions set out within this consultation seem appropriately targeted towards the capabilities of the DNOs as enablers of DSO rather than sole providers.

Market Development is one core area in which conflict may arise. This is particularly the case where ENWL have arguably forfeited the ability to be a neutral market facilitator by actively competing against other flexibility providers using CLASS technology in NGESO markets.

It is concerning that while Ofgem has repeatedly acknowledged the existing conflicts of interest and the potential impacts of these conflicts, it continues to defer any decision on separation or take comprehensive steps to address the conflict until such a time as a decision can be made. Energy UK understands that consulting upon, developing and delivering an approach to separation would be complex and require considerable resource, but expects that waiting until a conflict arises would potentially cause more resource requirements as well as additional cost to consumers.

It is important that Ofgem work to address this conflict itself, rather than relying on networks to self-regulate in the best interest of consumers.

OVQ18. Do you agree with our proposal to use the Business Plan Incentive to encourage companies to reveal standards of performance higher than our baseline expectations in their DSO strategies? Do you agree we should require, where appropriate, all DNOs adopt these revealed standards?

Where DSO functions are incentivised through RIIO-ED2, this approach seems appropriate. Where performance exceeds expectations all DNOs should be held to that revealed standard to ensure the best consumer outcomes.

OVQ19. Do you agree with our proposal to invite companies to provide metrics and performance benchmarks in their DSO strategies?

Energy UK agrees that this approach would be appropriate, but would also note that industry should be able to recommend metrics and performance benchmarks as well. This will go some way to incorporating the right metrics to develop market confidence and effective competition.

DNOs must be incentivised to improve transparency across the board, from publishing metrics and performance benchmarks to making available low voltage monitoring data. Regardless of how DSO functions are incentivised, any DNO that participates in DSO functions should be publishing full information about their approach.

Energy UK welcomes the clarity in the consultation that Ofgem will ensure that metrics and benchmarks are standardised across DNOs in RIIO-ED2 to ensure accuracy and fairness. Given the importance of DSO functions for the developing smart flexible energy system, performance against these metrics and benchmarks should be reviewed publicly each year.

OVQ20. Do you agree with our proposal to introduce a DSO ODI in which we would, via an ex post incentive, penalise or reward companies based on their delivery against baseline expectations and performance benchmarks? If so, what criteria and other considerations should we take into account in determining whether we should apply a reward or penalty?

Where DSO functions are incentivised through RIIO-ED2, this approach would be appropriate.

Market viability should be taken into account when determining reward or penalty, including number of participants, amount of flexibility procured, and a comparison of the flexibility procured compared to the amount of capacity operating under a 'Flexible Connection'. The amount invested in ANM and network flexibility should also be taken into account, as effective markets for flexibility should result in reduced investment in this area.

Customer confidence should also be noted, to reveal where flexibility providers feel that DSO functions are being carried out well and where conflicts of interest are noted.

OVQ21. Do you agree with our proposal to undertake that ex post incentive performance assessment in the middle and at the end of the price control? Do you think the assessment should be more or less regular?

If DSO functions are incentivised through RIIO-ED2, an assessment of performance should take place on a yearly basis. This need not be a complete incentive performance assessment, but key indicators of success or failure to meet benchmarks should be highlighted. This will allow for a regular review of the approach taken by DNOs to ensure delivery against ambitious benchmarks, as well as retaining optionality.

OVQ22. Do you have views on how we might set appropriate values for rewards and penalties associated with the DSO ODI?

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OVQ23. Do you agree with the DSO roles, principles and associated baseline expectations in Appendix 5? Does it provide sufficient clarity about the role of DNOs in RIIO-ED2? Do you think amendments or additional baseline expectations are required?

Energy UK broadly agrees with the roles, principles and associated baseline expectations that Ofgem has defined as part of its work on DSO roles, but additional clarity will be welcome on governance arrangements as the RIIO-ED2 framework continues to develop.

The baseline approach set out for whole system coordination of network operation, under A5.18, seems appropriate, but further detail will need to be developed around the dispatch merit order and the approach taken to resolving conflicts to ensure that system security is maintained but markets retain viability.

Network forecasting and equipment expectations should be set out transparently to ensure wider scrutiny is enabled, this includes publishing the cost benefit analysis to allow for network user scrutiny.

Continued ambiguity over flexibility market development and the role of DNOs and wider DSO-responsible parties will need to be resolved before the market and investors can be confident in the approach.

A whole system approach

From Energy UK's response to RIIO-2 Methodologies:

We welcome this whole system thinking and anticipate that it might find a role in the interface between the transmission and distribution systems, and across sectors. We consider an incentive should not be necessary but would support an annual process that best aligns with network planning cycles.

We agree that neither a materiality threshold nor an 'unforeseeable' condition should be required. Also, that it would seem appropriate to enable participation of electricity distribution licensees as soon as possible.

In this context we note the RIIO-2 Methodology consultation annex explaining the Exit Capacity Enhanced Obligations, but wonder if this is sufficient to ensure the best outcomes for customers, whilst also seeking further clarity on Ofgem's oversight role in normal circumstances and if there is a dispute if the networks are unable to agree. In this context we would support an annual process for reopeners linked to capacity booking considerations.

OVQ24. Are there any electricity distribution specific barriers to whole system solutions, and if so, are there any sector specific price control mechanisms to address these?

The availability of granular data on the state of the network remains a barrier to progressing whole system solutions, as is addressed in this consultation. A lack of clarity over the future levels of locational granularity of charging regimes is problematic, as these regimes will be critical to rewarding connected parties for their flexibility. This is particularly of importance when looking to LCTs, as heat and transport assets in particular will hold inherent flexibility that could otherwise fail to be utilised.

OVQ25. Are there any electricity distribution specific issues you think should be accounted for in the Business Plan Incentive?

The decarbonisation of heat and transport will result in many choices being made between gas and electricity, as well as between distributed or centralised solutions. Heat networks, rapid charging hubs, and a range of other technologies will create the need for far greater coordination. It is vital that the solution to these issues is focussed in ensuring that customers are being provided with more options rather than having options taken away.

OVQ26. Do you agree that whole system solutions are relevant to the innovation stimulus?

Energy UK agrees that whole system solutions are relevant to the innovation stimulus.

OVQ27. Do you agree with our key proposals for the CAM?

Yes, Energy UK broadly agrees with these proposals.

OVQ28. Do you consider that two application windows, or annual application windows, are more appropriate, and should these be in January or May?

Energy UK agrees with the proposed two application windows, and these must be aligned across gas and electricity, as well as across transmission and distribution.

OVQ29. Do you consider that the current electricity distribution licences should be amended to include the CAM, or wait until in 2023 at the start of their next price control?

Current licences should be adapted where possible. Energy UK has been engaged in the Open Networks Workstream 4 and broadly supports that approach. Where those products are developed ahead of 2023 they should be implemented across all networks to enable decarbonisation efforts to proceed in the most cost-effective fashion.

Access Significant Code Review and impact on RIIO-ED2

OVQ30. Do you agree with the impacts of our potential Access SCR proposals that are identified in this Chapter? Are there additional impacts that are not identified?

Energy UK broadly agrees with the identified impacts, but would note that this should remain open for consideration given the potential for new impacts to be identified. The impacts of flexibility accessed through non-firm access arrangements has not been properly addressed in this consultation, and further consideration of this is required.

OVQ31. Do you agree with the proposed Access SCR baselines for the RIIOED2 business plan submissions (ie that Draft RIIO-ED2 Business Plan submissions should use Access SCR Minded to Consultation as a baseline, and that Final Business Plan submissions should use Access SCR Final Decision as a baseline?)

Energy UK supports this approach.

OVQ32. How do DNOs propose to demonstrate the impact of our Access SCR reforms on RIIO-ED2 Business Plans?

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OVQ33. What further guidance might be required from us to allow DNOs to identify the parts of their draft Business Plan submissions that could be impacted by our Final Decision of the Access SCR?

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Impact of COVID-19 on the price controls

OVQ34. Do you think we need specific mechanisms in RIIO-ED2 to manage the potential longer-term impacts of COVID-19? If yes, what might these mechanisms be?

At this stage it is critical to ensure flexibility is integrated into the development process to enable changes to business plans based on wide-reaching impacts of COVID-19. For example, if consumers broadly continue to work from home, changing use patterns and location of energy use, networks need to be able to adapt plans to address that behavioural change. National Grid ESO has set out the additional cost of balancing the electricity grid throughout lockdown, and savings could be made on this increasing cost if flexibility was more widely utilised.

Green Recovery measures will also impact the amount of energy efficiency and low carbon technology that is taken up by consumers if support is targeted towards those options, as seen with the Green Homes Grant. This may similarly result in changes to business plans and the needs of the network across the board.