The voice of the energy industry

RIIO-2 Draft Determinations for Transmission, Gas Distribution and Electricity System Operator

4th September 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-2 Draft Determinations for Transmission, Gas Distribution and Electricity System Operator. We welcome the ambition for efficiency and reducing the cost to the consumer that these draft determinations have presented. However, we encourage Ofgem to consider stakeholder feedback on whether these proposals are workable for the required investment needed in the networks in context of net-zero and network resilience.

We note concern from the generators that timely connections under the proposed arrangements will be forthcoming. In consideration of the necessary reinforcement required to facilitate a connection, especially for those projects that are known, it would be appropriate to provide confidence that obtaining the allowed investment will not be a barrier to this. Further, work carried out in collaboration with LCP signalled a significant amount of financial investment in the networks to facilitate net-zero, the RIIO-2 determinations must not present a barrier to this. We note low-to-no regrets options for anticipatory network investment that we would deem appropriate to consider.

We also acknowledge the ability of networks to take advantage of the uncertainty mechanisms. The way in which this additional allowable investment can be accessed though is a concern to stakeholders. Ofgem should consider whether the process to allow a network to access justifiable additional investment is appropriate. The process must not have inappropriate levels of regulatory burden attached to it. Timeframes for a decision should be outlined, and support and collaboration offered to the networks to provide both corporate and investor confidence in the uncertainty mechanisms.

We encourage Ofgem to signal to industry the expectations of the final decision as soon as possible, and prior to the publication of the Final Determination. This is essential if suppliers are to appropriately prepare for the costs that they will be required to recoup from customers from April 2021. This certainty will allow suppliers to appropriately set tariffs.

If you have any questions, please feel free to contact me. I can confirm that there is no confidential information in this response, and we are happy for it to be published.

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Core Issues

Energy UK welcomes the ambition and efficiency stretch implicit in the RIIO-2 Draft Determination. It shows 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 realistic, and it should not stretch beyond what is reasonably workable for the networks.

We believe that it is essential that the RIIO-2 determination facilitates the net-zero transition and does not act as a barrier to the expected build out rate of new power generation required for net-zero. It must also allow the network companies to properly invest in their networks to maintain a proper level of resilience and security of supply.

Cost of capital

We agree that the cost of capital outlined in the final determinations must be reflective of a regulated monopoly, and those of prevailing market conditions. It must ensure a good deal for the end consumer. However, it is key that Ofgem carefully balance the need to drive down headline costs (through lower returns) while ensuring that network companies remain attractive to investors protecting consumers' longer-term interests.

We have no views or supporting data on whether the proposals are suitable, but we agree with the principle of the draft determinations. We encourage Ofgem to review its draft determination proposals in line with responses to ensure that the decision is robust and appropriate.

Incentives

We believe that well designed incentives are integral to the success of the price control and would encourage Ofgem to consider whether it has struck the correct balance in its draft determination, both in terms of the range of incentives and the ratio of upside to downside value. A number of our members have been supportive through the stakeholder engagement processes of particular incentive schemes which Ofgem is not proposing to take forward, and which would appear to offer valuable benefits. These include:

- **Outage and constraint management proposals**: All three TOs and the ESO proposed a number of ODIs relating to outage and constraint management that have been rejected by Ofgem. They included a process in response to feedback received from industry at OC2 forums, individual and group stakeholder feedback and at least one successful pilot project. The pilot project clearly demonstrated the opportunities available to reduce outages, highlighting the limitations of both the existing arrangements and the natural drivers that the TOs and the ESO have. Usually, the generators most affected by (often very long) unpaid outages are those on single circuit non-firm connections which by default will predominantly be onshore windfarms. Examples exist where large generators have been switched off for 9 months with no recompense and no option to consider any alternatives, and where neither the TO or the SO considered the additional O&M costs incurred by the generator or the loss of production. Solutions exist that can reduce outage times thereby reducing O&M costs, grid system BSUoS costs, generator reliability and therefore security, but it has been proven (through the carrying out of pilot schemes) that appropriately placed incentives are required to create the appropriate outputs.

- **Connections linked with carbon abatement**: We note that two of the TOs were looking to introduce ODI/CVP in the area of facilitating and accelerating low carbon connections and low carbon transfers across GB. Ofgem either considered the approaches should be business as

usual or were too difficult to measure. We would question whether 'too difficult to measure' is a valid reason not to progress with a project and we would encourage any incentives or propositions directly linked to reducing carbon to be worked through to a positive solution.

Uncertainty Mechanisms and Re-openers

We acknowledge the ability for network companies to access additional allowed investment through the Uncertainty Mechanisms, and recognise this is a necessity to the funding model of a network to provide flexibility to emerging and unexpected investment needs. Energy UK is of the view that the network companies need clear reassurances that this process will be collaborative, and a decision from the Authority will be forthcoming as soon as possible.

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 to provide more confidence in how to provide Ofgem with the information required 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 happen 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. We would not anticipate revised charges arising from reopeners only being published with minimum notification lead-times. Adequate lead-times are required to ensure network charges are efficiently reflected in customer tariffs.

Ofgem is proposing a process for reopeners by licensees where applications are submitted in January, with a decision expected in time for the annual iteration process (AIP) in the autumn. Energy UK would like to understand the process more fully regarding how outcomes impact network charges paid by consumers. Ideally the consultation with stakeholders on the reopener should include indicative charges arising from the reopener for the remainder of the price control period. We would like to seek assurances that there will be no short notice changes to charges.

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. Whether 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.

In regards to the heat reopener, we are not clear why this only relates to gas distribution and not gas transmission as some of the triggers are relevant for the transmission system. We would welcome clarification from Ofgem on this decision.

Gas Charging

An issue with charging, not associated with reopeners, also arises at the start or the price control period, with respect to how charges paid by the gas distribution network arising from the implementation of UNC Mod 0678A from October 2020 will be recovered via ECN charges. The normal mechanism is for there to be a two-year lag in gas distribution allowance adjustments but it is

not clear whether this will happen from April 2021. Gas distribution networks face diverse impacts of this change to gas transmission charges, so we call for a consistent approach and clarity on this issue as soon as possible to ensure network charges are efficiently reflected in consumers tariffs

Whole System

Energy UK notes with interest the coordinated adjustment mechanism reopener that allows activities to be moved between licensee's price controls.

We welcome this whole system thinking and anticipate that it might find a role in the interface between the transmission and distribution systems, or perhaps 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, it would seem appropriate to enable participation of electricity distribution licensees as soon as possible.

In this context we note the annex explaining the Exit Capacity Enhanced Obligations, but question whether this is sufficient to ensure the best outcomes for consumers, 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.

Net Zero

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 at transmission to support large scale low carbon generation and for the 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.

Electricity Transmission

Interactions with decarbonisation targets

Energy UK's concerns revolve around the importance of RIIO-ET2 in relation to the necessary investment in networks required to meet net-zero and renewables targets. The RIIO-ET2 decision must not act as a barrier to these ambitions.

Earlier in 2020, Energy UK, in collaboration with LCP published findings on the cost of the electricity system meeting 2050 net-zero targets.[1] It found, based on the Committee for Climate Change net-zero scenario, that between £30 to £40 billion will need to be spent in building new transmission network assets. We also note that in National Grid ESO's (the ESO) 2020 Networks Options Assessment (NOA) four new HVDC bootstraps and four new overhead lines will be required to meet the projected renewable buildout rate until 2040. This work also estimated that to meet net-zero targets for renewable generation 10 new HVDC cables and supporting overhead lines would be required.

In the context of the above, RIIO-ET2 must not act as a barrier to this investment, particularly in consideration of those renewable units already awarded a CfD. Many of Energy UK's members already experience long lead times between receiving a connection offer and having connection works to the network completed (some reports of 10 years). This is due to reinforcement works required to facilitate the connection. Energy UK's concerns regarding Uncertainty Mechanisms are covered in the 'Core Issues' section, however, we do consider anticipatory network investment being carefully facilitated in the framework would increase efficiency and ensure consistency with Ofgem's Decarbonisation Action Plan.

We are concerned that Ofgem propose up to a 30-month assessment process with multiple submissions to demonstrate need and cost efficiency (and even longer if competition is pursued). This will add significant risk to projects when trying to meet CfD, Power Purchase Agreement (PPA), or other

[1] Net Zero: Investing in low carbon generation: https://www.energy-uk.org.uk/publication.html?task=file.download&id=7617

commercial arrangement deadlines. Along with these delays, cuts to pre-construction funding - which is essential for early scoping - design, and planning activities, will further increase the risk for offshore wind and more complex connections. Furthermore, these timelines increase the risk of renewable investments being stalled or delayed significantly.

The investment in the networks must be obtainable for the connections (and associated works) to ensure that generation projects come to market as expected, and their investments are not undermined. This is also pertinent for generators that will come to market over the course of RIIO-ET2 but have not necessarily come to final investment decision at the time of final determination.

We note that many network owners and operators have developed their own pathways or plans to achieve net-zero targets. It is important that investments are aligned with a single plan, and there must be consistency across the network companies (ESO, TO etc.).

Network companies' participation in ancillary services

Providing funding that enables network companies to invest in assets in order to participate and compete with commercial providers in areas outside of their licences can cause distortions in markets. Network companies are responsible for assessing their network needs; proposing the appropriate reinforcements; they hold the data relating to network needs and can tailor and re-design solutions.

Some transmission networks (but this also include distribution 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.

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 we would welcome further discussions with Ofgem to outline our views and concerns. 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 to assess potential service providers when it does not have full regulatory oversight.

Electricity System Operator

Energy UK would like to highlight our view that there should be suitable investment in the ESO to ensure that it can invest appropriately in its new IT infrastructure. This will be a key enabler to new investment in the GB electricity system.

Stakeholder feedback has historically typically been critical of IT developments by the ESO. We are positive of steps taken by the ESO over the past year. It must, however, be appropriately enabled to perform to the standard expected by stakeholders with a suitable funding regime and allow it to be ambitious.

Although we welcome the ESO developing its own IT infrastructure and having ownership over it separate to the rest of National Grid group, this must not act as a barrier to communications between the different organisations.

Also, the ESO has a critical role in supporting system resilience and whole system considerations. We agree with the principles for the ESO to have a 2-year outlook applied. This, however, must not detract from the necessity for the ESO to be appropriately incentivised and funded to look beyond this 2-year and to a further out horizon.

Gas Transmission

NGGTQ1. Do you agree with our proposals for the Customer Satisfaction ODI-F?

Yes, it is important that incentive targets are set to provide continuous improvement not just reward business as usual

NGGTQ2. Do you agree with our proposals for the Quality of Demand Forecasting incentive?

Yes, we agree the focus should be on the D-1 forecast

NGGTQ3. Do you agree with our proposals for the Maintenance incentive?
Energy UK agrees that since the introduction of a financial incentive for maintenance activities there has been a substantial improvement in liaison with customers and alignment with customer activities. We also note that the existing incentives do not cover the full range of maintenance activities. We hope that Ofgem is right in that these practices are now fully embedded within NGG and represent a cultural shift in its approach to maintenance and greater recognition of its customer needs. If this is the case the incentive package is appropriate.

NGGTQ4. Do you agree with our proposals for the CCM incentive?
Historically NGGT has performed well against constraint management incentives and from a stakeholder perspective it has been difficult to understand how the targets are set. For RIIO2 NGGT provided more supporting analysis on this than before. However, it is the case that constraints rarely occur and it is difficult to design an incentive scheme to efficiently incentivise behaviours for low probability potentially high impact events. It maybe that in the long run it is better for industry to save on the cost of the incentive through the lower proposed targets and face the constraint costs as they occur rather than continue to pay incentive upside to NGGT routinely.

We agree with the removal of entry overrun charge from the scheme as overruns generally arise from errors and NGGT should not benefit from this.

NGGTQ5. Do you agree with our proposals for the Residual Balancing incentive?
Yes, the introduction of a wider performance range in the shoulder months is appropriate

NGGTQ6. Do you agree with our proposals for the GHG emissions incentive?
Yes, in principle we agree incentives should be symmetrical but consider there should be some element of corporate responsibility here.

NGGTQ7. Do you agree with out proposals for the NTS Shrinkage incentive?
Yes, historically the shrinkage incentive has been something that NGGT has performed well against, but some of this has been fortuitous by either reduced volume requirements or falling prices rather than NGGT direct actions. We also agree it is appropriate for NGGT to report to Ofgem on its shrinkage procurement costs.

NGGTQ12. Do you agree with our proposals for LO in relation to NCAM and ANCAR?
Yes, the network capability assessment methodology and capability report will be of interest to Energy UK members and the industry generally. A further element that needs to be considered is an articulation of within day capability which is essential for ensuring that gas generation plant can respond and operate flexibly when intermittent renewables are not generating. As the energy system decarbonises swings in gas generation are likely to become more pronounced

NGGTQ13. Do you agree with our proposal not to set network capability targets for RIIO2?
Yes

NGGTQ14. Do you agree with the proposal to reduce entry baseline capacity at St Fergus?
Yes, this is a reasonable level

NGGTQ15. Do you agree with the proposal to reduce entry baseline capacity at Theddlethorpe?
Yes, but we would also like to see a requirement to establish a mechanism that recognises that this physical capability is not lost and can be subject to substitution

NGGTQ22. Do you agree with our proposed GT Project Assessment Process?
Energy UK is aware that the process for reopeners for compressor investment did not work well under RIIO 1, for a number of reasons and it is important that lessons are learned from that and an improved process implemented for RIIO2.

The proposed process appears to align with NGGT's own project development process more closely should provide for better outcomes, and more appropriate allowances, so long as the steps in the process are managed collaboratively and do not lead to delays. Supporting re-openers at an appropriate time in the project seems sensible. Although as with all reopeners we are keen to understand the process including timescales for these and impacts on allowed revenues and hence charges to customers, which should be signalled well in advance.

IT is also important to recognise here the role that compressor play in the operation of the system and ensuring it can meet the needs of customers offtake profiles. Compressor investment is not only about compliance.

NGGTQ23. Do you agree with our proposal to provide baseline funding for Hatton subject to us conducting further volume and cost assessment prior to our Final Determination?
Yes, as the needs case is already established

NGGTQ24. Do you agree with our proposal to accept the need for investment, provide baseline funding for development work and assess the full project costs during RIIO-GT2 for the compressor projects at Stage 1 - Needs Case Assessment (Wormington, St Fergus, King's Lynn and Peterborough and Huntingdon)?
Yes, we broadly agree with this approach, noting the number of re-openers that will follow and the need for an efficient process for these. We are not sure whether fixing dates for the re-openers is the best way to proceed as issues can arise during the development of options. We think these should be indicative dates.

Q26. Do you agree with our proposed approach for costs confidence, including our view and rationale for high and low confidence cost categories and costs subject to a BPI Stage 3 penalty?

Asset health is complex and technically challenging area that Energy UK is not well placed to comment on in detail. It is also an area that has significant expenditure.

We reflect that NGGT's stakeholder engagement process identified that stakeholders wished to retain the same level of network reliability and resilience and were content for charges to remain constant to achieve this. Whilst the appropriate level of costs is an issue for Ofgem and NGGT, cost reductions whilst maintaining the same level of service would be welcome. However, it is not clear whether the draft determination proposals deliver the same level of service at lower cost or whether if the draft determination were to become the final determination that customers may see reduced levels of network reliability and resilience in the short of longer term.

NGGT has estimated the level of risk would increase by 7% over the next ten years and by 19% in the longer term. This is a concern given the role the gas network must play in ensuring the security of the electricity supply as coal plant retire and renewables penetration increases. Also, in the role that the gas network may play in decarbonisation of the energy sector on the pathway to net zero. Energy UK is not in a position to verify these impacts but has concerns if these increased risks impact on supply to NGGT's customers and in particular gas generation which could also impact the electricity market.

NGGTQ27. Do you agree with our proposed approach to approve the need for investment, provide development funding and assess the full project costs through a UM during RIIO-GT2, for the Bacton, St Fergus subsidence and King's Lynn subsidence projects?

Energy UK broadly agrees with this approach where options and costs remain uncertain. We would also like to seek assurance that option development also considers future pathways at terminals including suitability of equipment for Hydrogen blend, 100% Hydrogen and the potential for import / export at Bacton and landing of hydrogen produced offshore at both terminals. This is not to require additional spend now rather to explore how they would be accommodated in the future, so at to avoid more costly options at that time.

Q29. Do you agree with our proposed assessment approach and baseline allowances for non-operational Capex costs, including IT&T, STEPM, property and vehicle fleet investment?

Energy UK has some concerns with the reopener structure proposed in relation to IT spend for statutory / regulatory requirements, whilst we accept that there is uncertainty in respect of the projects themselves. Only two reopeners are suggested one at the start of the price control and one in 2023. In practice, if projects are not more fully developed in the next few months this leaves one reopener.

We think a more dynamic approach is needed, perhaps an annual process or some other mechanism to ensure that IT system requirements are delivered in a timely manner. There may be potential to link this with the modification process since projects with substantial IT spend are likely to be linked to UNC modification proposals that will go to the Authority for decision.

Q34. Do you agree with our proposed UM for incremental capacity, specifically the timing and content of the Pre-Application Notification stage, the Needs Case and Cost Assessment timings, and the need for an exceptional events mechanism?

Energy UK supports this approach as it more closely ties in with specific project costs than the generic revenue driver mechanism. However, we seek assurance that the process will not introduce delays in the delivery of capacity to customers. We consider that the pre-application notification could link to the PARCA process. We also seek assurance that the impact on charges on such projects will be notified well in advance an enable shippers to forecast future charges accurately.

Q39. Do you agree with the level of proposed NIA funding for NGGT? If not, please outline why.

Energy UK recognises the need for better reporting of the outcomes and benefits of RIIO1 NIA spend, we consider that the Gas Goes Green project goes someway to deliver this. NIA projects have historically been small but are funded by customers so this is reasonable. We also think that there is a challenge for the networks in embedding innovation outcomes in business as usual and communicating that, although we recognise that much of the spend is in preparation for hydrogen blend in the system.

With respect to the level of funding we have some concerns as to whether this level of funding will be sufficient to deliver the levels of innovation necessary to support decarbonisation pathways on the path to net zero.