Grid Edge Policy Ltd

To: RIIO2@ofgem.gov.uk

31 August 2017

Re: Response to Ofgem's open letter on the RIIO2 Framework

Until last year, I was a Senior Partner at Ofgem responsible for all aspects of regulation of the distribution networks including setting the RIIO1 price control for the electricity DNOs and overseeing the performance of all networks under the RIIO framework. I am keen that the experience that I gained through this process is not lost as Ofgem starts to think about its approach to RIIO2. I am now working as an independent consultant (Grid Edge Policy), including for some regulated companies, however this response is submitted in a personal capacity.

Having seen the effects that RIIO has had in driving behaviour by the companies, putting more focus on innovation and the customer, I have become a strong advocate of the RIIO approach. RIIO was the result of an extensive review of the previous price control regime ("RPI-x@20") looking at how the regulatory framework needed to evolve to cope with the challenges of moving to a decarbonised energy system. This is a challenge that regulators globally are having to address and RIIO is often held out as a role model[1]. As such I am pleased that Ofgem is not proposing to move away from the fundamental principles of RIIO while, rightly at this stage, looking at how some elements might be strengthened.

I have set out below my thoughts (based on my experience of RIIO1) around four key areas for improvement, which broadly reflect the themes in the open letter, and have annexed responses to the individual questions.

There is also a question about the scope of this review. While it is inevitable that electricity DNOs will have to engage with this debate on the evolution of the RIIO framework it should be remembered that they are only 2 years into an 8 year control and should not yet be doing significant work preparing for the next price control.

One lesson from RIIO1 was where asset lives were changed for all networks including the DNOs as part of the GD / T price control process. Although there was a separate consultation on the proposals for ED1, the issues were looked at relatively superficially and account could not be taken of the specific impacts for DNO business plans. Major issues subsequently emerged which needed to be addressed in ED1 through introducing transition arrangements and, as part of the appeal on ED1 Ofgem acknowledged that a more fundamental review would be needed as part of RIIO2. This highlights the problem of decoupling significant policy thinking from the more detailed work of developing business plans and setting the actual price controls. Thus, while some elements of the RIIO framework for DNOs will need to be considered as part of this wider review, Ofgem should be wary of trying to do too much DNO specific policy development at this point.

More generally there is a sense within the open letter that Ofgem has done more thinking about the potential evolution of the electricity sector than the challenges on gas. Given that the first RIIO2 controls are focussed on gas, it is vital that Ofgem gives equal if not more attention to the developments in that sector.

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[1] See for example the recent report from Berkeley Lab https://eta.lbl.gov/sites/default/files/publications/multiyear_rate_plan_gmlc_1.4.29_final_report071217.pdf

Turning then to the areas for improvement in RIIO2.

1) **The potential for increased consumer / stakeholder input**

One important issue that Ofgem raises is the potential for increased end-consumer input into the RIIO process. In discussing this it includes an oblique footnote reference (FN11) to the paper I prepared at the end of my time at Ofgem on this question (albeit not intended to represent a formal Ofgem position). This drew extensively on my experience of the RIIO process and a review of the approaches taken by other regulators and international experience. As such it merits full and proper consideration as a part of this process.

Reflecting the original RIIO conclusion that what was needed was both enhanced engagement by the companies and enhanced engagement by Ofgem, the key points that I would emphasise based on my review are as follows.

While the focus is on the consumer perspective, given how broadly that is articulated in legislation (including in particular the need to reduce greenhouse gases, the interests of future consumers, safety and the particular focus on vulnerable customers) this is not simply about engagement with end-consumers but with a wider set of stakeholders who can bring specialist perspectives.

It is important to articulate where consumer input is likely to be most valuable and where not, to help in managing expectations. In most sectors the conclusion has been that consumer groups would not be expected to contribute on the cost of capital for example. Ofgem's CCG for RIIO was deliberately established to include representatives with specialist skills that could allow them to contribute to such more technical debates but most stakeholders would not have that sort of expertise.

However there will be elements of price controls where consumers / stakeholders may be best placed to judge what is needed and Ofgem should seek to identify these areas in advance and to make clear the basis on which it would accept those positions without further challenge. For example on interruptions Ofgem has historically insisted on a standard incentive across all DNOs (which obviously facilitates cost benchmarking). However the expectations of customers in different regions and the practical challenges faced by DNOs will vary. Ofgem should be ready to allow more flexibility in this area and to support tailor made incentives if there are particular regional considerations and clear consumer support.

Given the wide definition of the "consumer interest" and the need to trade-off between, for example, current and future consumers or vulnerable and non-domestic customers, it is difficult to envisage how negotiation of a settlement could simply be left to a consumer challenge group (as in WICS) or to users (as in airlines[2]). Ofgem itself is there to represent the interests of consumers and has consumer expertise on its board. It is hard to see what additional value would be created by establishing a new body to negotiate with the networks as envisaged in the negotiated settlement model.

That said there may be some specific issues for which such an approach would work. In my paper I give the example of the NG compressor upgrades where shippers and suppliers are probably best placed to judge what additional capacity will be needed in future and a negotiated settlement could

[2] It should be noted that in airlines the CAA has now required Heathrow to establish a Consumer Challenge Panel to supplement the previous approach of negotiation just with the airlines

have worked there if NG had been willing to share the cost-benefit assessments of different technical options.

On network company engagement specifically I believe that RIIO has led to a step change in the extent of stakeholder engagement both through the price control process and (prompted by the ongoing stakeholder engagement incentive) on an ongoing basis. The DNOs were able to build on the experience of the GDNs and hence their approach to price control engagement is current best practice and is summarised in my report. Ofgem should make clear that the bar continues to rise as best practice develops.

The most successful of the DNOs used a range of techniques for engagement, started engagement early in the process (ie not just consulting on their plan), and involved senior management to hear the views of consumers first hand.

Allowing the networks flexibility in how they engage (rather than mandating a particular approach as has been done in other sectors) encourages them to explore different approaches and allows best practice and new ideas to develop.

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2) Managing uncertainty

One of the challenges with RIIO – and in particular given the level and pace of change in the industry - is how to take account of uncertainty.

This was a particular issue under an 8 year control. While there were good reasons for moving to an 8 year control in terms of creating a longer term focus (and facilitating more radical reforms), the pace of change in the industry means that a 5 year time horizon now involves a level of change that might previously been expected in a period twice that length. As such I believe that Ofgem is right to consider returning to a shorter period.

One of the weaknesses of the current regime is the number of re-openers and other mechansisms that Ofgem included to cope with uncertainty. This leads to a complex regime and a sense of micro management. Moving back to a 5 year period might allow Ofgem to reduce the number of uncertainty mechanisms required and to simplify the regime.

If moving back to a 5 year period Ofgem should consider how best to continue to encourage longer term thinking and whether there would be merit for example in requiring the companies to provide longer term projections beyond the price control which could be used to track future performance and to judge how the companies' plans will deal with the longer term uncertainty, for example on the future of gas.

Although not mentioned in the open letter, regulatory uncertainty is an important consideration for networks and increased risk in this area can add to the cost of capital and ultimately costs for consumers. Ofgem talks about the risks of stranded assets as one element of uncertainty facing the companies. It is vital that any consideration of this question is linked with questions around the cost of capital – they cannot be considered in isolation.

Another area of uncertainty currently facing the networks and not mentioned in the open letter is on the impacts of Brexit, with equipment costs increasing sharply and new challenges in maintaining a skilled workforce. While some of these issues may be clearer by the time the price controls come to be settled, it is important that Ofgem does not avoid discussing such matters out of political sensitivity but rather looks objectively at the implications of what is a wider shift in the economic landscape.

3) Fair returns

One obvious thread in the open letter (and associated commentary by Ofgem) is a concern that companies have been earning excessive and unjustified returns. The concept of "legitimacy" is a new and helpful one – high returns can be justified if they are the result of efficiency and innovation - and I would argue exceptional customer service. They are a problem if they result from mis-forecasting or windfall gains as a result of falling interest rates, for example.

But the misconception that continues to be promulgated is that this means there will be a "natural dispersion" of returns. That might be a reasonable expectation but there is no reason in principle why all companies couldn't earn at the top end if they were all strong performers. Or indeed why they shouldn't all see low returns if they let things slip. This should be about absolute not relative performance. There shouldn't be prizes for winning "the fat boys race" and an arrangement that encourages sharing of ideas and knowledge (so that all can excel) must be in consumers' interests in this sector.

4) Simplifying the regime

One of the questions Ofgem raises is around how the regime might be simplified both to increase transparency and reduce regulatory burdens. This is a valid objective and there is a concern that by collecting very detailed information Ofgem risks micro-managing the industry.

There is also a point that with the current "cherry picking" appeals mechanism, the more complex the regime and the analysis underpinning it, the greater the number of potential areas where companies can pick an appeal. A simpler price control should be more defensible.

However as Ofgem acknowledges, there is a challenge with information asymmetry and in the absence of more detailed information to support its decisions to make cuts to company business plans such decisions would be hard to support on appeal. Also collecting information on an ongoing basis helps ensure that Ofgem maintains an understanding of the drivers of costs and again helps overcome the information asymmetry problem. There is therefore a balance to be struck.

In terms of the various incentives that exist to drive behaviour there is again a question as to whether there are too many or whether they are too complex. In some areas incentives were needed initially to drive a shift in behaviour with the question being whether such incentives are still required.

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- Overall Ofgem should not worry too much about the number of incentives if they are all helping drive valued behaviours. However the calibration of the financial rewards associated with some of the incentives in RIIO1 was relatively unsophisticated which risks over-rewarding the companies in aggregate. The challenge for Ofgem will always be how to present what is inevitably a complex set of arrangements in a way that allows stakeholders to see the big picture and to engage effectively in the debate.

I hope these comments are helpful and I will follow the RIIO2 process with interest.

Yours sincerely

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Director Grid Edge Policy Ltd.

Annex: Responses to individual questions

1. Overarching objective – agreed in principle but this should not mean we simply take the views of end-consumers as determinative. The requirement to consider future consumers and the impacts of greenhouse gas emissions means it is not just about what consumers today say they want and need.

2. Consumer voice – see cover letter. It's good to see a strong focus on bringing the consumer voice into the debate and the open letter picks up on some of the angles explored more fully in my paper that is on the Ofgem website. One of my lines in that paper is that something closer to full negotiated settlement might work in transmission where (as in airports) the users of the system are actually industry players with whom some deeper dialogue on future requirements might be possible and valuable. For the distribution networks the real question is for Ofgem. How far is it willing to let end consumers define different standards in different regions reflecting different local priorities – or does it want to stick with a set of national incentives which facilitates benchmarking? Ofwat has historically allowed different incentives in different regions but for PR19 is moving to standardise the metrics while still allowing companies to set their target level based on consumer feedback.
I also believe that this needs to be about more than just the direct end-consumer but should include a wider set of stakeholders.

3. Ongoing engagement – I am not convinced an ongoing stakeholder engagement incentive is necessary but Ofgem should make clear that it still expects companies to engage and that this will be relevant in judging engagement leading upto the next control (RIIO3). The incentive seems to have done its job in driving a culture change in the companies and they should now recognise the value that such engagement brings. Given it is inevitably a subjective measure anyway (which can be demotivating for companies if they feel under-rewarded) it is one that Ofgem might consider dropping.

4. Output definition – The structured approach to defining outputs is helpful in providing clarity. It is also worth being clear that, based on RIIO1, companies can be expected to agree some specific outputs with stakeholders as part of the business planning process which may be distinct from those which Ofgem defines and reflects in the price control. This is a valuable part of the process, responding directly to stakeholder interests at a local level.

5. New categories of outputs – as per my cover letter I would be wary of trying to define new output categories for DNOs at this stage.

6. Outputs and behaviours – yes the outputs broadly targeted the right behaviours.

7. Expenditure without clear outputs – Ofgem is right to focus on outputs where it can but there may be some instances where “input” measures are required (eg delivery of specific projects). Recognising Ofgem’s desire also to simplify the regime it should ensure that any set of “input” measures is limited to those which involve very material expenditure.

8. Financial incentives in RIIO1 – In broad terms the incentives focus on the right areas. In terms of assessing “what consumers truly value” it is worth noting again that the consumer interest as defined in legislation is broader than simply the direct interests of today’s

consumer. Hence, for example, incentives in support of carbon reduction (such as biogas connections) might not reflect consumers' willingness to pay but should reflect established cost of carbon figures.
That said, I believe this is an area where Ofgem could do more to ensure that the level of incentives reflects consumer willingness to pay. Historically Ofgem has used willingness to pay (and value of lost load) studies to calibrate the interruptions incentives. However other incentives have been set on a more subjective basis. As noted in my paper on consumer engagement the fact that Ofgem has historically set the levels of the incentives before the companies submit their business plans means that there has been limited consumer / stakeholder input. Either Ofgem needs to allow the companies to work with consumer groups to define their own incentive structures (as Ofwat has done) or Ofgem needs to find a way to get more consumer input into its own thinking in this area.

9. Returns that are demonstrably good value – Ofgem is right to introduce the concept of legitimacy here. If companies are performing well they should get good returns – the concern is with windfall gains from errors in forecasting or changes in certain parameters. However as noted in my cover letter it is not automatic that there will be a dispersion of returns – when Ofgem talks about the "best performing" companies earning high returns this should be judged against an absolute not a relative standard. While one might expect the companies to be dispersed in terms of performance this will not necessarily be the case. There is also an issue with the calibration of the level of incentives where Ofgem could do more (as per my response to q8).

10. Minimising forecasting errors – As the open letter acknowledges, forecasting errors can arise either from companies exploiting the information asymmetry or windfall gains due to economic conditions differing from forecasts. The answer to the first lies in the IQI regime, fast tracking and ongoing monitoring by Ofgem to build up a knowledge and understanding of the sector. The answer to the latter lies in indexation or other forms of uncertainty mechanism. Inevitably these add to the complexity of the regime but are important to help reduce unjustified returns by the companies.
One specific area where there is potential for windfall gains not covered in the open letter is on real price effects. As part of finalising RIIO ED1 we consulted explicitly on a range of options for dealing with the uncertainty in that area. The conclusion was that there was not time to do justice to what is a complex area but Ofgem should revisit the work that was done and look at this explicitly for RIIO2.

11. What is a fair return – There is an established methodology for setting baseline returns in regulated sectors but less has been done on what is an acceptable range. Some of the backlash against network company returns comes from the fact that many people do not distinguish between the network companies and the suppliers, where there have been many more performance issues and customer trust is lacking. The fact that networks are achieving customer satisfaction scores on a par with the top performing companies in any sector provides some evidence that they are actually high performing. Recent work by Sustainability First (to be published shortly) found that networks were widely seen as doing more for vulnerable customers than suppliers. The levels of efficiency gains by the networks are high compared to the US. It is also worth noting that in storm scenarios the level of response that companies provide is probably not one that could be justified based purely on financial metrics looking at the incentives. There is a natural tendency for regulators to not

want to sing the praises of the companies they regulate but as noted in my cover letter RIIO is viewed positively in the US for what it has delivered and Ofgem could do more to set out what the networks are delivering and how they perform judged against an international standard. Putting more focus on the outcomes being delivered not simply on the level of returns would help inform debates around the legitimacy of those returns.
One specific point that Ofgem should revisit is the sharing factor in the efficiency incentive (as per my response to q26). Consumers would be more accepting of high returns and outperformance if they were to get a larger share of the immediate benefit. This needs to be balanced against continuing to provide a strong incentive to drive for efficiency but arguably the current sharing factors give too high a proportion of any outperformance to the companies.

12. Cost of capital. Ofgem notes the high premia on recent transactions which it attributes to investors accepting lower long term yields. The alternative interpretation is that there is an expectation of consistent outperformance (which would probably be of equal concern to Ofgem but may be more legitimate).
In reviewing the cost of capital it is important that issues such as the risk of stranded assets are taken into account. Even to voice this potential risk represents a change from past approaches where the RAB was seen as guaranteed, justifying the low cost of capital. Developing an appropriate solution to the stranding question will be vital to keeping the cost of capital low, and hence is in consumers' long term interests.

13. Indexation of debt and equity - The approach to debt indexation was considered as part of the RIIO1 appeal and supported by the CMA. The opportunity to explore indexation of the cost of equity is something that Ofgem has previously flagged that it would consider in RIIO2.

14. Financeability – Not that I am aware of at this stage.

15. CPIH – While there is pressure more generally to move to CPIH as a measure of inflation this should not in practice make any difference in net present value terms as an equivalent adjustment would be made to the cost of capital. Ofgem has recognised this in past papers it has produced on this subject in relation to the OFTO regime. The core issue ends up as who takes the risk on the CPI-RPI "wedge" given the lack of a liquid CPI linked debt market – but for pension funds whose liabilities are increasingly on a CPI basis there may be some appeal. The main risk is that Ofgem may come under increased public pressure if real returns appear higher because measured on a CPI not RPI basis. It is important that Ofgem maintains its stance that any change would be NPV neutral.

16. Aligning the electricity price controls – It is unclear how Ofgem would propose aligning the two electricity controls and the pros and cons are dependent on the approach chosen. There clearly are strong arguments for aligning electricity transmission and distribution (given increasing interactions) but this should not be done by cutting short the ED1 control (given the implications this would have for regulatory uncertainty). Running a two year rollover control for transmission would leave the transmission companies with either weak incentives or a lot of work to do two controls in a short period.

17. Other alignment options - An alternative could be to align further in the future (eg by running one 6 year and one 4 year control) and to rely on requirements around co-ordination and consultation on the business plans to promote joined up thinking. Alternatively one could simply rely on re-openers to deal with any interactions from other price controls.
    As the open letter notes there are also question about the gas – electricity system considerations in particular with the potentially different scenarios that exist for heat which could have major ramifications for gas and electricity distribution. There is less obvious synergy between GT and ET.
    Clearly running all price controls on the same time line would lead to undue burdens and peakiness of work for both Ofgem and the industry. An effective solution to cross sector co-ordination (such as a formal obligation to consult other networks) will therefore be needed to cover some interactions. In any event simply aligning timing does not necessarily mean that the companies will co-ordinate and Ofgem teams under pressure cannot be guaranteed to work effectively across price controls either. Other actions to improve co-ordination will be needed in any event.

18. Amendments to encourage smart alternatives – There have already been significant steps to encourage networks to use smart alternatives, in particular the use of totex allowances (with the split into fast and slow money being based on set percentages not on actual capex spend). This combined with the incentives for efficiency and innovation has led to a significant uptake by the DNOs of smart solutions even at this stage. What has not yet been properly worked through and will require more consideration ahead of ED2 is how the "option value" of using smart solutions is treated in benchmarking exercises. It may make sense for networks to opt for smart solutions even if they are more expensive in the short term if that creates option value when there is uncertainty as to whether further reinforcement will in fact be needed depending on the actual level of future demand, for example. Further thought should be given to this issue to ensure that Ofgem's approach to benchmarking does not inadvertently favour capital solutions.
    Also, as flagged in my covering letter, all the emphasis in this area seems to be on electricity despite the fact the DNOs are only 2 years into their control. Given that the first RIIO2 controls focus on gas there is a need to think through what the equivalent issue is in that sector. With the heat strategy still under consideration, it is important that GDNs have suitable incentives to look at alternatives to conventional infrastructure investment. This could include, for example, allowing GDNs to invest in alternative heat solutions (from energy efficiency, through to heat network or heat pumps) as part of RIIO if that were a more cost effective / future proofed solution.

19. Asset stranding (how much of an issue and how deal with) – There clearly is a serious risk around asset stranding in particular on gas networks depending where government policy lands in relation to heat. Investors in these networks have invested based on a regulatory compact under which the RAB is secure and to move away from that would represent a radical increase in the risk and cost of capital required. Addressing the issue early to mitigate the risk is clearly important. In RIIO GD1 Ofgem took an approach which sought to minimise the risks by using shorter asset lives and front loading the depreciation profile. In addition Ofgem would only support investments that had a relatively short payback period. This approach should be revisited and built upon for GD2. There are also links with network charging to ensure that these are as far as possible sending cost reflective signals to

discourage premature or inefficient asset stranding as set out in Ofgem's paper on fixed and sunk costs (which focussed on electricity but where the issues also apply to gas).
Allowing GDNs to look at alternative solutions (as per my response to q18) is one possible response.
The Frontier paper for the Climate Change Committee also highlighted the need to improve understanding of decommissioning costs which would be a relevant factor in the event that gas networks were to becomes stranded.

20. How to deal with uncertainty – More generally there is a need to work closely with government on its review of the heat strategy and to consider the timeframe for RIIO3 and any reopeners needed to allow the control to be adjusted as policy becomes clear.

21. Move from eight-year control – As per my covering letter I believe that a return to a five year control would now be justified with the increasing uncertainty.

22. Assessment of business plans – In assessing the companies' business plans Ofgem should give full weight to the views of consumers/stakeholders, rather than simply relying on conventional benchmarking techniques. To help with this Ofgem may wish to engage more directly with the company stakeholders rather than having all messages relayed through the mouthpiece of the company (in contrast to the Ofwat model where the CCG chairs do engage directly with Ofwat at key points).
In terms of the benchmarking techniques that Ofgem uses these would generally seem to represent best practice.

23. Considering historic performance – the accuracy of companies' past forecasts could be a helpful indicator in assessing their business plans and is a reason why companies are now required to provide annually updated forecasts.

24. Determining an "efficient" network revenue up front - The one novel idea in the open letter is that Ofgem would determine the level of costs at the beginning of the process with companies then required to justify any deviations from that in their plans. It has some appeal – and if Ofgem is looking to significantly strengthen consumer engagement in the price control (eg a negotiated settlement model) then stakeholders would need that sort of input. However what Ofgem hasn't made clear is how it actually proposes to do this. If it was that easy then we wouldn't need the whole protracted price control process and the top down and bottom up benchmarking (which Ofgem seemingly still plans to do). The idea behind fast tracking and IQI is to try to get companies to reveal what they really can do – with the stretch target of the most ambitious then used to set allowances for the others. There would still need to be a strong incentive for companies to submit plans that improve on whatever Ofgem may initially be thinking. So in my view it would be odd (and impractical) for Ofgem to "determine" the costs upfront. However the idea that it could provide guidance on an expected upper bound is worth exploring. Most regulators could – at the beginning of the process and simply by looking at high level trends - form a view of where they might expect to land. And the fact that under RIIO companies have to provide a rolling forecast each year will help. But Ofgem does keep emphasising the extent of change anticipated over the RIIO-2 period which means that information asymmetry will as ever be a major problem. This is an interesting idea but I am not convinced that it is do-able in practice.

25. Benefits of eight year control – My understanding is that companies have undertaken more radical changes to their contracting strategies and workforce structures than they might have done under a 5 year control given that the longer control provides an opportunity for companies to undertake projects that have a longer payback. There was therefore a good case for moving to an eight year control. However as per my answer to question 21 I believe that the balance has now shifted.

26. IQI/Efficiency incentive – the efficiency incentive has been very effective in encouraging efficiency through the price control period. However as alluded to above, arguably rewards have been too strong and consumers could have benefited from a higher share of the savings which would have helped with the legitimacy of companies' returns. Clearly there is a trade-off here – a stronger incentive should deliver larger savings which consumers will benefit from ultimately at the next price control. However in my view the balance is not right at the minute and with a genuine 50-50 sharing mechanism companies would still have adequate incentive to drive for efficiency while consumers would see an earlier benefit.
The IQI mechanism is very complex and something of a black box. Hence there must be questions as to whether Ofgem is able to calibrate it to effectively meet their policy goals and whether all stakeholders can fully understand and comment on the options. Ofgem should put effort into providing a simple explanation of its working as a part of this process.
In my view the main driver for companies to provide ambitious business plans is the fast track process which while linked to the IQI mechanism provides broader rewards.

27. Information asymmetry - Requiring the companies to update their forecasts each year has been one of the "unsung" strengths of RIIO and makes it harder for companies to radically change their forecasts come the next price control. Given the long term nature of these assets (and notwithstanding the level of change) one would expect the companies to have longer term forecasts beyond the price control period. Requiring companies to provide longer term projections beyond the immediate control period could also help with the problem of information asymmetry going forward.

28. Innovation stimulus – This has been very successful in driving innovation and changing the culture in organisations. From an international perspective the UK is seen as having moved from being a laggard to being at the forefront of much of the technology. Companies put a lot of effort into sharing their findings as required by the incentive and this has been of real benefit to the sector as whole.
While the innovation funding mechanism has been successful in changing the culture, I believe that it continues to be needed. While it is in companies' interests to invest in innovation that will lead to cost saving within the price control period they do not have the same incentives to innovate in relation to greenhouse gas reduction and the incentives are weaker in relation to longer term efficiency savings (where the regulator will be expected to recoup any benefits for consumers). As noted above, a critical feature of the RIIO funding is also that learning is shared across the industry. If relying purely on commercial incentives this would not happen. As such the innovation mechanisms continue to play a valuable – and arguably increasingly important role.

29. Incentives for innovation – While the focus has been on the innovation stimulus itself there are, as Ofgem acknowledges, other features of the price control (the use of totex, the longer duration control and efficiency sharing) which also help drive innovation.

30. Scope of competition – While competition can bring benefits Ofgem should be clear where risks sit and that the benefits of competition are real and not simply a reflection of risks being passed on to consumers.

31. Simplifying the regime – The question of how the framework could be simplified is a good one but as noted in my cover letter there are trade-offs here with the effectiveness of the regime.

32. Improving business plans – It is clear that the RIIO requirements for a well justified business plan have led to business plans that really are more like real plans than simply regulatory "bids" as was the case historically. Most of the DNO plans were quite extensive but they typically also included shorter summary documents, hence addressing the needs of different readers. With the increasing levels of uncertainty there may be more need for companies to be explicit about how they would deal with a range of different scenarios. In terms of the format there clearly was a diversity of approaches and some guidance would be helpful – but I would be wary of providing templates which risks a return to these becoming regulatory submissions rather than business plans.

33. Revising plans – It feels disproportionate to require the companies to completely revise their plans each year given the volume of material produced. Companies do already have to provide updated forecasts each year and some justification for changes. There is probably scope to build on that process as a way of delivering what Ofgem needs. During the price control process itself the companies do update their plans in light of feedback from Ofgem.

34. Fast tracking – It is clear that fast tracking has most benefit when there are a reasonable number of companies in the sector to encourage a competitive spirit and so that the benefits of getting a company to produce an ambitious plan can then flow through in terms of providing Ofgem with evidence to challenge the business plans of the other companies. This points to greater benefit from fast-tracking for distribution companies than transmission.
    There is a separate question about the rewards that are given for fast-tracking and whether such a high reward is needed in future (given the company benefits also from the time saving and reduced scrutiny).

35. Monitoring performance – There may be scope to reduce the volume of information collected but it plays an important role in helping address information asymmetry.

36. RIIO for elec SO – There is clearly a need to unpick the SO elements of the RIIO control given the current plans for separation. Whether the SO merits a full blown RIIO price control in its own right is a moot question. The behaviours that Ofgem is looking for the SO to adopt are hard to handle with objective output based metrics. Moreover as an asset light business the traditional RAB model is less obviously relevant. For some elements of the SO's role Ofgem has already had to employ an "ex post plus" approach to deal with the high levels of uncertainty around systems development. However the concepts of RIIO – looking for more

consumer / stakeholder input, incentives for outputs, driving innovation – all are still very relevant. A tailored RIIO "lite" approach may be the best approach.

37. Stakeholder approach – In the open letter Ofgem says that in line with the principle of enhanced engagement the key responsibility will remain with network companies to engage stakeholders in developing their response to the Framework Review. This does not accurately reflect the idea of "enhanced engagement" which covered both enhanced engagement by Ofgem and enhanced engagement by the companies. While there are elements of the Framework Review on which network companies should properly engage their stakeholders, many of the questions that Ofgem raises are about regulatory design and it is therefore for Ofgem to ensure that it has appropriately engaged with the full range of stakeholders as part of this process to inform decisions that it will take, rather than for networks. Moreover, the timescales for responding to this open letter will inevitably limit how far networks can engage with their stakeholders in developing their responses.