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Ørsted response to Ofgem's consultation on RIIO-2 Draft Determinations

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The Ørsted vision is a world that runs entirely on green energy. In the UK, we develop, construct and operate offshore wind farms as well as battery storage and innovative waste-to-energy solutions. We also offer flexibility solutions to our industrial and commercial customers as well as supplying them with electricity and gas. Headquartered in Denmark, Ørsted employs 6,000 people, including over 1,000 in the UK. Ørsted is the largest offshore wind farm developer, generator and owner in the UK and we are currently constructing Hornsea Project Two which was awarded a CfD contract in Allocation Round Two at £57.50/MWh.

Our ref. JAMJC/RIIO-2

We welcome the opportunity to respond to the consultation on Ofgem's Draft Determinations for the upcoming RIIO-2 price control period. The Draft Determinations clearly highlight Ofgem's ambition to invest appropriately in networks, with a drive to ensure that only efficient costs of operation are passed on to final bill payers.

We wish to highlight some areas of focus in our response, primarily regarding how the Draft Determination affects the delivery of Net Zero as well as the balance between network efficiency and innovation, which we set out below. Our more detailed responses to the consultation can be found in the Annex for both Transmission and ESO Draft Determinations.

Delivering Net Zero

In combination with continuing to deliver value to consumers, the RIIO-2 price control, and subsequent controls will also need to prioritise delivery of a decarbonised energy system in line with Net Zero legislation passed in 2019. This won't be possible under the current UK grid framework, and both the system operator and network operator will need to be appropriately funded to develop new and innovative practices. We therefore expect a full tranche of change, from the way in which developers to connect, to the management of the UK system. Networks need to evolve at pace, to match the anticipated changes in generation and demand, where we will see sectors like offshore wind install 40GW by 2030 under the Government's sector deal, along with the ending of the sale of petrol and diesel vehicles and subsequent uptake in battery electric vehicles.

Our hope and expectation is that RIIO-2 will facilitate this change as we transition to Net Zero, rather than act as a barrier to the required build out rate of power

generation. Alongside this, the price control must also allow operators to properly invest in their networks to maintain a proper level of security of supply.

For the most part, we believe the Draft Determinations support these objectives. However, we have concerns over how long-term strategy has been accounted for in these proposals, which seem to be lost in favour of short-term gains.

Dealing with uncertainty

In principle, Ørsted are supportive of the concept of Uncertainty Mechanisms (UMs) and their anticipated use for the price control, as well as the proposed Net Zero reopener, as gates to unlock further spending. To allow all potential costs at the start of the price control period would not be an efficient use of spend or deliver a benefit to the end consumer. However, Ofgem must carefully consider how each of the funding allowances will work in practice. We do not believe it would be beneficial to create a scenario in which it becomes increasingly onerous and burdensome for either the TO or a DNO to provide the evidence and justification to build new infrastructure.

In addition, for both UMs and the reopener to be a success they must be designed in an agile manner in order respond to change. Without this, we believe there is a danger that reinforcement and connection works could be delayed from the combined result of establishing too many individual UMs and reopeners – that are also time-consuming – to unlock spending. For generators looking to connect to the system that rely on timely connections, a risk exists that could see power plants that are ready to generate lacking an accompanying network that is sufficiently reinforced. It is important for transmission-connected generators to avoid the situation seen in distribution networks whereby non-firm connections are incorrectly viewed as the norm, given the scale of investment into major generation assets.

Details on the design, timing and workings of the mechanisms are limited within the Draft Determinations. We therefore call on Ofgem to provide additional practical information in order to provide operators, developers and investors with certainty and confidence in the mechanisms.

The balance between efficiency and innovation

Ofgem need to ensure that the correct balance is struck between efficient operation of the networks and providing a level of funding that allows for safe and reliable operation. We note that a large proportion of the spending cuts made to business plans relate to operation and maintenance of the network. Delivering a network fit for Net Zero goes beyond delivering new capacity. Maintaining a reliable network is vital to ensuring existing generators can continue to operate and deliver low-carbon electricity to consumers and should be accounted for when setting funding levels.

In addition to the investment that facilitates the networks to operate in a business as usual manner, Ofgem must also consider the grid of tomorrow. New and innovative measures will be required to achieve Net Zero, as well as provide a stable and resilient grid. Ofgem need to maintain a position that is forward thinking, with consideration and allowance made for projects, asset management and technologies that stretch beyond the price control period.

Please do not hesitate to reach out (07768 288836, jamjc@orsted.co.uk) should you have further questions about our response.

Yours sincerely,

James Jackson

Regulatory Affairs Advisor

Annex

Core Document

Q21. Do you agree with our overall approach to meeting Net Zero at lowest cost to consumers? Specifically, do you agree with our approach to fund known and justified Net Zero investment needs in the baseline, and to use Uncertainty Mechanisms to provide funding in-period for Net Zero investment when the need becomes clearer?

and

Q22. Do you think the package of cross sector and sector-specific UMs provides the appropriate balance to ensure there is sufficient flexibility and coverage to facilitate the potential need for additional Net Zero funding during RIIO-2?

In a broad sense Ørsted support the approach outlined by Ofgem. We agree that some form of reopener or Uncertainty Mechanism (UM) makes sense – it would not be reasonable, or economically efficient, to include the full Net Zero scope within baseline funding. However, Ofgem must take care when considering the definition of justified Net Zero investment. An appropriate balance will need to be struck between providing consumer value and allowing networks to innovate and lead in delivering a pathway towards Net Zero.

We note that alterations to the charging mechanism throughout the price control period may also lead to uncertainty due to fluctuating recovery charges. For network users such as transmission-connected generators that typically consist of large-scale investments, increasing uncertainty in charges that are consequently passed through to network users for recovery will increase risks to existing and future users to commit to using the networks.

In order to foster confidence in the UMs from both network owners and investors, we encourage Ofgem to provide timeframes for decision upon triggering an UM. It may also be suitable to offer network owners further clarifying guidance with regards to the information Ofgem would require as part of an UM application, in order to give confidence that requests will be processed in an efficient manner.

Q23. Do you have any views on our proposed approach to a Net Zero re-opener?

In order for the re-opener to be a success, Ofgem will need to ensure that companies are able to utilise the available funding in a timely and accessible manner.

However, at this stage there is little clarity on the design of the specific net zero re-opener or criteria proposed for the allocated £10bn spend. For example, the development of offshore grid regime and decarbonisation of heat would require

immense amount of work over the upcoming RIIO-2 period. Ofgem should clearly set out the materiality threshold, timings and assessment stages which would apply to any project which falls within the scope of the Net Zero re-opener. We welcome more detail on the specific design of the Net Zero re-opener as we progress towards the final determination in the final quarter of 2020.

NGET Business Plan

Q3. Do you agree with our proposal to reject the Accelerating Low Carbon Connections ODI-F?

Ørsted agrees with Ofgem's overarching position and note that the connection date is partly generated from discussions between the developer, NGET and NGESO. We understand the merits of being able to obtain an earlier-than-expected grid connection date, but believe the current process places a lot of the ability to determine the connection date with NGET and NGESO prior to signing any Bilateral Connection Agreements (BCA).

As such, we agree with Ofgem that additional contingency could be built into delivery in order to deliver any such incentive. We do, however, acknowledge some potential workarounds in this regard in order to mitigate for the risk. Likely the most appropriate would be to allow the ESO to provide an independent validation service, in order to ensure that the agreement to connect the customer is fair and reasonable in terms of timeframe. However, any such independent arbitration and validation must not further slow an already slow process.

Additionally, the most value in gaining an earlier connection date is at the beginning of the project development cycle (i.e. at point of signing the BCA, from which further project expenditure commences). Announcing that an earlier grid connection is possible late into the development cycle has little benefit to a project which has already signed agreements with suppliers and an established work programme that cannot be altered without significant cost.

Consequently, in the case of existing contracts that have already been agreed between NGET and the developer, we believe there would only be a limited scope for the ODI to be of value. Nonetheless, given that delivery timeframes would have already been agreed upon, the risk of exploitation is far reduced.

Q12. Do you agree with our proposed allowances in relation to non-load related capex? If not, please outline why.

We note that the deductions outlined by Ofgem are very drastic. Though we agree with Ofgem that NGET should fully justify their plans, Ofgem must also consider the future. In order to achieve Net Zero, appropriate system upgrades that enable a stable and flexible grid, will be vital.

In addition, asset health expenditure has been reduced to around 80% from TOs proposals in the Draft Determinations. However, relying on the 'do the minimum' approach such as refurbishments could mean that works need to be carried out every few years to ensure reliability. Not only will this result in higher costs in the long-term, it will also mean network users will experience outages each time refurbishment takes place.

Q17. Do you agree with our proposal to use a funding route more directly linked to actual engineering work on individual projects, and to provide a further route for funding through a re-opener window?

Though we understand the merits of a funding route that links directly to individual projects, we suggest that a wider, portfolio approach to O&M procurement may be cheaper and more efficient for consumers at large. As Ofgem outline in their decarbonisation action plan¹, it's crucial that the consumers of both today and tomorrow are protected as we transition towards Net Zero. With this in mind, we believe consumers will receive better value in the long-term if an approach is taken in which anticipatory, portfolio investment is accounted for.

This strategic approach also provides more of an opportunity to innovate, with the risk of a project being unsuccessful managed against the consumer benefits that innovation can bring, across a broader scope.

ESO Document

ESQ5. Do you agree that a financial reward or penalty should be determined every two-years, to align with the period over which we set expectations, costs and outputs?

Whilst we understand the intent from the regulator to introduce a two-year reward or penalty period, we would be concerned that a two-year cycle would place the majority of the focus of the ESO onto short term change, and subsequently influence the ESO to prioritise short term deliverables. We would like to see the ESO become less reactive and instead look towards transformative, longer-term, investments that signal its role as a leader in system decarbonisation.

As stated in our original response to the RIIO-2 sector methodology for the ESO², a two-year model that contains five-year elements would allow the ESO to take on more transformative initiatives and blends out risks presented in a two-year only model by creating exposure to a longer term revenue profile.

ESQ8. Do you agree with our proposals on the incentive scheme value?

Yes, we believe the values outlined strike a fair balance between incentivising performance and penalising for lack of delivery.

¹ [February 2020 – Ofgem decarbonisation action plan](#)

² Please see our response, submitted to Ofgem 16 March 2019

ESQ9. Do you think that our proposals will capture the full scope of minimum obligations/standards associated with the ESO's Business Plan activities?

Ørsted agree with the change to licence conditions. It will be of benefit to transparently set out the expectations of an economic, efficient and coordinated ESO.

We also agree with the listed obligations and standards. All are of relevance and will be key in the future system, in particular the coordination of a strategy for the planning and operation of offshore, onshore and cross-border networks, as well as wider system thinking.

However, we would also expect to see a reference to flexibility when setting out the expectations of the ESO. The secure and efficient operation of a flexible grid will be key in delivering Net Zero, and as such should be reflected and promoted within the scope of the standards. We consider this to be of further importance given the likely cross play between the standards and obligations outlined and the development of the future role of the system operator.

ESQ32. Do you believe our price control design is sufficiently flexible to account for uncertainty? Are there any relevant foreseeable future uncertainties which we have not identified here?

We are pleased that Ofgem recognise that there may be a material change to the ESO's roles or responsibilities as work relating to offshore coordination progresses. This programme of work remains in its early stages and as such the full scope, as well as potential outputs, are difficult to forecast. We therefore agree that an adjustment to the price control could be necessary during the period.

ET Annex

ETQ11. Do you agree with our proposed definition of PCF for RIIO-2, and the areas of work that we intend that definition to cover?

and

ETQ12. Do you agree with our proposal to assess PCF costs as part of RIIO-2 Closeout, following the principles set out in Chapter 4?

The pre-construction funding (PCF) mechanism proposed presents a significant risk to delaying the connection of new projects. Pre-construction work is essential for early scoping, design and planning activities and provides a project – and its stakeholders – with a level of clarity and investment certainty with regards to Ofgem approval of the scheme.

Furthermore, the use of an ex-post adjustment places a greater burden on network operators, who will seek to mitigate this uncertainty by de-risking programmes so less of consumers' money is spent at risk. Ultimately, we are concerned that the proposed mechanism may stifle innovation and create a scenario in which the TOs are reliant on using a 'do the minimum' approach to more complex connections.

Finally, we disagree with Ofgem's indicative view that the efficient cost of PCF be set at 2.5% of total project. The value appears to have been derived through an arbitrary process, with a weighted PCF average of nine projects used as an evidence base. We do not consider this analysis to be of sufficient detail or breadth to set the threshold as suggested.

More crucially, setting PCF at 2.5% of total project cost does reflect the true value of development in many cases and could cause delays to projects as a result. Ofgem must therefore provide further information on the rationale for introducing a limit, as well as conduct additional analysis on the potential impact prior to progressing further.