Scottish & Southern Electricity Networks

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Akshay Kaul
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Ofgem
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4 September 2020

Dear Akshay,

SSEPD response to RIIO-T2 and GD-2 Draft Determinations

We (SHEPD and SEPD) welcome the opportunity to respond to Ofgem's consultation on the Draft Determinations for RIIO-T2 and GD2.

In this letter, we flag a number of key considerations which we believe are also relevant in the context of RIIO-ED2. We provide a full response to individual questions raised in the Core Document and annexes in Appendix 1.

1. Enabling Net Zero

RIIO-2 should be an enabler for Net Zero. However, our view is that by focusing on achieving bill reductions, Ofgem has failed to consider costs to future consumers and the wider societal impacts associated with the risk of non-delivery.

Draft Determinations could have substantial impacts for low carbon technologies seeking to connect to the network, including at distribution level. For example, the introduction of re-openers to replace volume drivers is likely to cause significant delays to any party seeking to connect to the network. In addition, the proposed removal of pre-construction allowances and cuts in inspection and maintenance allowances will have profound implications for some of our customers, in particular on Skye and the Western Isles. This is both in terms of security of supply and ability to connect to the network in a timely fashion.

We note that the ability to take local variations in policy and opportunity into account will be central to enabling Net Zero through RIIO-ED2. We would like to work with Ofgem to ensure the framework for RIIO-ED2 strikes the right balance and delivers the best outcome for consumers.

2. Business plan assessment process

Business Plan Incentive

We have concerns around the application of the Business Plan Incentive (BPI) in RIIO-T2 and GD2 and the extent to which it has achieved its stated aim. We are concerned that the design of the BPI is skewed towards the downside, with limited scope for companies to receive rewards for ambition and quality. We would urge Ofgem to reconsider its approach for RIIO-ED2 to ensure the BPI incentivises the right behaviour.

We note that there is an apparent gap between Ofgem's expectations and network companies' understanding of these, for example around the Consumer Value Propositions (CVPs). We would ask Ofgem to provide DNOs with as much clarity as possible on what constitutes a high-quality business plan for the purposes of the BPI. We welcome the additional guidance Ofgem has already provided in its updated Business Plan Guidance document for RIIO-ED2.

Cost assessment

In a number of areas, Ofgem has not provided sufficient justification to support its proposed approach. For example, we note Ofgem's rejection of SHE Transmission's proposals for landowner compensation which involves the combination of a baseline allowance and a re-opener. We do not think the Draft Determinations clearly explain the rationale for rejection, including why the proposal is not in consumers' interests. We are also unable to identify from the documents the amount that Ofgem has allowed in the baseline. Finally, as highlighted in SHE Transmission's response and in the ENA response, there are significant errors in Ofgem's cost assessment which must be corrected.

Stakeholder engagement

The extent to which companies' stakeholder engagement and feedback from Consumer Engagement Groups (CEG) and User Groups has been given due consideration in Draft Determinations is unclear, for example in the context of CVP proposals that were endorsed by stakeholders, such as SHE Transmission's proposal for a science-based target for controllable emissions. This is a concern that has also been flagged by a number of our stakeholders, including our Stakeholder Advisory Panel (SAP).

As we move into the next phase of our extensive stakeholder engagement programme for RIIO-ED2, we would welcome confirmation from Ofgem on the role that stakeholder engagement will play in RIIO-ED2, and the extent to which it will be accepted as evidence as part of Ofgem's decision-making process.

3. <u>Managing uncertainty</u>

We have significant concerns with Ofgem's proposed approach to managing uncertainty, which we think could have significant implications for companies' ability to deliver Net Zero for consumers.

The heavy reliance on uncertainty mechanisms, mainly in the shape of re-openers, is overly burdensome for both Ofgem and network companies, creating significant uncertainty and risking unnecessary delays to investment. We recognise the need to protect customers and believe that the right balance could be achieved through greater use of baseline funding, combined with more mechanistic approaches such as volume drivers.

We do not support Ofgem's overall approach to re-openers and the removal of a number of safeguards that exist in the current RIIO-ED1 licence, for example the significant shortening of re-opener windows, and the lack of clarity around timescales. The introduction of a fair and robust framework for re-openers that provides clarity to stakeholders and confidence in regulatory decision-making will be central to the successful delivery of Net Zero. This will allow companies to continue providing high-quality services to their customers, and work with their supply chain to plan ahead and deliver efficiencies.

4. Finance

The overall financial framework for RIIO-2 has been in development for several years since the RIIO-2 Framework Consultation in 2018. The industry has responded to the Sector Specific Methodology Consultation (SSMC) for GD2 and T2, the Sector Specific Methodology Decision (SSMD) for GD2 and T2 and now the Draft Determinations for GD2 and T2. The ENA Finance Working Group has presented significant evidence over this period. This includes submitting evidence to and attending third party hearings at the CMA for NERL's appeal of RP3 and the four water company appeals of PR19.

We have been continuously engaged through the ENA Finance Working Group and made representations, presented evidence and been party to the issues raised throughout that period. Specifically, we have highlighted the number of errors made by Ofgem to date in determining the financial parameters for RIIO-2, principally the cost of equity and other associated measures such as the outperformance wedge.

At this stage, we believe Ofgem has set the cost of equity too low, as supported by the following evidence[1]:

a) Relying on novel approaches to the treatment of inflation through the deflating Total Market Returns (TMR) using a 'backcast' of CPI inflation currently under review by the ONS.
b) Equating the risk of energy networks to that of UK Water which market data on observable beta's does not support.
c) Incorrectly applying the estimates to the Risk Free Rate within the CAPM by using spot rates on government gilts instead of a more appropriate proxy as supported by academic evidence.
d) Applying an 'outperformance wedge' to RIIO-GD2 and T2, thereby creating an adverse incentive which is likely to cause harm to consumers. We also note that the data published by Ofgem at Draft Determinations relies on RIIO-1, which is not complete, as well as other regulatory price controls in energy and other regulated sectors. This is inappropriate and potentially unreliable as data is missing and not verifiable, in addition to being highly irrelevant to the price control.
e) By aiming at the bottom of the range and therefore breaking from regulatory precedent as set out recently by the CMA's decision on RP3, where the middle of the range was selected, with an acknowledgment that there may be a case for aiming up in the range. There is sound academic evidence and regulatory precedent supporting the view that the risk of underinvestment is more costly to society than that of overinvestment, and that regulators should err on the side of caution when setting the cost of capital.
f) Ofgem has incorrectly relied upon cross-checks of inferior quality and reliability such as the Dividend Discount Model (DDM), infrastructure fund discount rates, OFTOs, and Market to Asset Ratios (MARs).
g) Ofgem has incorrectly interpreted evidence on debt beta and not considered observable market data.

Ofgem has relied on significant methodological changes to support a materially lower return on equity, rather than changes in market data. Separately, we note that Ofgem has switched to the Utilities Index for the cost of debt. We note that this has no defined credit rating, meaning energy

[1] Oxera (2019), 'The cost of equity for RIIO-2', prepared for the ENA
Oxera report, The cost of equity for RIIO-2 – A review of the evidence, Prepared for the ENA, (Feb 2018) available at: https://www.oxera.com/wp-content/uploads/2018/07/ENA-cost-of-equity_2018-02-28.pdf
Oxera (2020), 'Are sovereign yields the risk-free rate for the CAPM?', prepared for the Energy Networks Association, 20 May.

networks will carry credit risk. We also do not believe Ofgem has correctly calculated the additional costs of borrowing, in particular the New Issue Premium (interpreted by an error in estimating the Halo Effect), and also the impact of transitioning to CPIH. Ofgem must take care to ensure debt costs can be fully recovered and there is no risk of underfunding during the period.

Finally, with regard to the financeability framework, we have concerns regarding the notional company definition and how this has changed since the SSMD for RIIO-T2 and GD2. We note that the assumptions around the proportion of Index Linked Debt (ILD) has increased from 25% to 30%. When reviewing the RFPR data for 2018/19, we note that the proportion of ILD across the full sector is actually lower at 25%. When removing NGGT and NGET this falls further to around 10%. We also note Ofgem has changed the gearing to 55% for T2 while also including the outperformance wedge in their financeability assessment. These have the effect of improving credit ratios but the evidence for these changes is not presented. This appears to break with regulatory best practice and must be addressed by Ofgem.

We have not provided specific responses to the questions in the Finance annex. Please refer to the relevant responses from SHE Transmission.

5. <u>Procedural proposals</u>

Ofgem's Draft Determination includes a number of procedural proposals including the introduction of post-appeals reviews and prescriptive requirements for pre-action conduct. Ofgem has also sought to categorise and enumerate examples of interlinked aspects of the price control in advance of any appeal of the licence modification decisions relating to the corresponding Final Determination. While we agree with the principle of seeking to ensure the efficiency of the regulatory appeals process, Ofgem's proposals risk undermining the basis of the statutory appeals framework and jeopardising the ex-post appeal rights of parties affected by licence modification decisions, with an expectation that the appeal process will result in finality and certainty. Furthermore, these proposals run contrary to the CMA's stated approach and decisional practice in previous regulatory appeals. We have set out in the attached Appendix further explanation as to the significant concerns associated with these procedural proposals.

The application of any of the proposals set out in the RIIO-T2 and GD2 Draft Determinations to RIIO-ED2 will require careful consideration and a transparent consultation process. We are keen to work closely with Ofgem to help ensure RIIO-ED2 delivers for consumers now and in the future, recognizing the wider societal impacts of achieving Net Zero ambitions. We would further urge Ofgem to develop processes for RIIO-ED2 that are transparent, proportionate and fair. We look forward to engaging further on these matters through the Sector Specific Methodology Consultation and upcoming working groups.

Yours Sincerely,

Clothilde Cantegreil
Head of Regulatory Strategy, RIIO-ED2

Appendix 1: responses to consultation questions

__Core document__

Q1. What role should Groups play during the price control period and what type of output should Groups be asked to deliver? Who should be the recipients of these outputs (companies, Ofgem and/or stakeholders)?

We support Ofgem's proposals in this space. Our view is that any enduring role for the Customer Engagement Groups (CEGs) should focus on holding companies to account for the delivery of their business plans, with emphasis on a targeted number of areas. For example, this could include vulnerability, Net Zero and the environment. Our strong preference would be for CEGs to remain company-specific and independent. We do not think that sector-wide groups would have sufficient time, resources and understanding of local specificities to be in a position to effectively hold companies accountable for delivering against business plan commitments.

Q2. What role should Groups take with respect to scrutinising new investment proposals which are developed through the uncertainty mechanisms?

While there may be a role for CEGs in scrutinising new investment proposals, our view is that, in the context of electricity distribution this should only happen by exception and should only be considered for material projects. The involvement of CEGs is likely to add to the amount of regulatory burden already associated with proposals for uncertainty mechanisms. There would need to be clear commitment from Ofgem that evidence provided by the CEGs would be explicitly considered as part of the decision-making process. We also note that CEGs are not currently set up to provide this kind of input and there are likely to be significant implication, for example in terms of costs and logistics, of involving CEGs in scrutinising proposals. This may change the shape and focus of the CEG and limit its benefit in other area.

Q3. What value would there be in asking Groups to publish a customer-centric annual report, reviewing the performance of the company on their business plan commitments?

We agree that the publication of a customer-centric annual report could provide additional value, in particular where targeted at specific aspects of performance (for example vulnerability, net zero, the environment, as highlighted above). The right balance will need to be struck to ensure appropriate and effective governance underpinning these reports. In the context of electricity distribution, our preferred approach would be for the CEGs to provide commentary and feedback to be included as an additional chapter, appendix, or layer to existing DNO reports. This would mean that stakeholders would only need to read one report and would also allow for a more streamlined approach to governance.

Q4. What value would there be in providing for continuity of Groups (albeit with refresh to membership as necessary) in light of Ofgem commencing preparations for RIIO-3 by 2023?

We think that there would be value in this, in particular in terms of facilitating a more effective on-boarding process. However, there would be a need to ensure that (i) membership and operation of the groups are refreshed appropriately, and (ii) there is clarity on roles and responsibilities relating to RIIO-2 and RIIO-3, with no unnecessary overlaps or potential conflicts of interest.

We would encourage Ofgem to look to other sectors for lessons-learnt and examples of best practice, for example the Customer Water Forum in Scotland.

Q5. Will the combination of the two proposed Licence Obligations support the delivery of a digitalised energy system and maximise the value of data to consumers?

We welcome the strong focus on modernising energy data, and recognise data is key to unlocking system and consumer benefits and managing the transition to net zero. Digitalisation also improves the accessibility and optimisation of energy data allowing the wider industry to develop and innovate together. This aligns well with investments we are making in digital capabilities in RIIO-ED1 and our trajectory to digital maturity.

We will provide separate commentary on the draft licence conditions, once made available. While we agree with the overall direction of travel, it is important that the drafting of licence conditions allows for flexibility in how companies take their digitalisation strategies and action plans forward, and choose to apply data best practice. In designing and applying the regulatory framework, Ofgem must recognise the experimental and iterative nature of the digitalisation process, and the importance of company strategies being user-led, evolving with their needs. There is otherwise a risk of creating unintended consequences, for example by being too prescriptive or penalising companies seeking to trial new approaches that may not always be successful.

Digitalisation Strategy and Action Plan

We support the introduction of a new Licence Obligation requiring the companies to publish a Digitalisation Strategy and accompanying Action Plan.

We expect funding required to implement our plans to be recovered through baseline allowances, justified through cost benefit analysis looking at the short, medium and long term. However, we recommend that Ofgem keeps open the option to use uncertainty mechanisms where requirements change or evolve.

We would welcome clarity from Ofgem on the funding justification for digitalisation. As recognised by Ofgem, much of the value of data is realised through new third-party products/services and efficiencies that will facilitate future customer needs. It is therefore critical that Ofgem capture the societal benefits of digitalisation and open data when reviewing DNO investment plans.

In the context of RIIO-ED2, data and digitalisation will also be critical to enabling DSO functionality and Net Zero, by allowing DNOs to plan and operate their networks in a way which maximises the benefits of smart systems and flexible solutions for consumers, while facilitating decarbonisation. This will also involve working with third-parties to make data available and facilitate the provision of new and innovative services to DNOs and beyond. However, further clarity is required to understand requirements, build a framework and determine the potential cost implications and regulatory mechanisms required to deliver on time and in an efficient way. For example, new skills, personnel and ways of working will be required to fully realise the benefits of digitalisation, which we are actively considering. Considerations of which company-specific and industry tools are required to facilitate this is important and should coordinated through the appropriate industry processes and built into our business plans.

Data Best Practice

We are already striving to ensure we follow best practice and learn from the successes of other sectors. We support the development of new guidance on data best practice. However, we question whether the use of a licence obligation is appropriate in the context of “best practice”. Best practice involves setting out key principles supported with examples, not specific methodologies, therefore implying an element of discretion in its application. On the other hand, licence obligations usually apply in the context of clear and unambiguous requirements. We would encourage Ofgem to consider whether such an approach is suited to the uncertain nature of the digitalisation process. We would also ask that Ofgem clarify its intended approach to enforcing the new proposed obligation.

We strongly agree that data should be “presumed open”, as per the recommendation of the EDTF, recognising the need to ensure data is protected as appropriate through a Data Triage Process. However, further work is required to understand the implications of a “presumed open” approach in terms of timeline for delivery and associated costs. This will be supported by the ongoing industry initiatives such as the Modernising Energy Data Access competition, in particular the emerging work around Shared Data access.

Q6. Do you agree with our proposed frequency for publication of updates to the digitalisation strategy and the digitalisation action plan, respectively?

We agree with the proposed timings for updates to the strategy (at least every two years) and the action plan (at least every six months).

Q7. What kinds of data do you think should comply with the data best practice guidance to maximise benefits to consumers through better use of data?

Our view is that data practice best guidance should apply to any data that relates to electricity network assets and operations, and that is required and efficiently gathered to enable the safe and efficient operation of the network.

Q8. Do you agree that the Groups could have an enduring role to work with the companies to monitor progress and ensure they deliver the commitments in their engagement strategies?

Yes, we agree with the proposed approach. As highlighted above, there would need to be clarity around the role and remit of CEGs in this space, and the extent to which Ofgem will engage with these groups and take into account any views or evidence provided. Please see our responses to Q1-3 for further details.

Q9. Do you agree with our proposal to accept the proposals for an ODI-R for BCF and the other proposals set out above as EAP commitments and to require progress on them to be reported as part of the AER?

RIIO-ED2 should build on the framework that currently exists in RIIO-ED1, increasing consistency and transparency in measuring DNO performance, and introducing stretching scientific targets that are both ambitious and achievable.

<u>Reputational ODI and Framework Reporting</u>

We support the use of a reputational ODI for BCF minimum requirements. However, we ask that Ofgem provide clarity on common methodologies, such as supplier codes, and appropriate tools. We would also welcome a discussion around roles and responsibilities for the development of these methodologies.

We also support CVP offerings in relation to BCF where these represent value above and beyond minimum requirements. We would urge Ofgem to work closely with the companies to help ensure appropriate and robust methodologies for valuing CVPs that meet Ofgem criteria can be developed.

In the context of BCF, we also see a potential impact in terms of increased unit costs. This is because, to reduce their carbon footprint, network companies would have to source local equipment. This will have a knock-on effect on procurement approaches and methods. We would propose further discussions on this matter to ensure baseline funding enables sufficient flexibility to support Net Zero goals.

We support DNOs publishing an Environmental Action Plan (EAP) that looks beyond ED2. We will work with our stakeholders to develop targets for activities included in the EAP. We will propose specific deliverables, where appropriate, to be funded through the business plan and support the introduction of a transparent, robust, and proportionate reporting framework.

Minimum Requirements

We broadly agree with the EAP commitment minimum standards. While we think these are a good starting point for RIIO-ED2, it is important to ensure stakeholders are given the opportunity to provide input prior to these being finalised.

We do not propose minimum requirements should be set out in licence. We do however support suggestions that efforts should be made to ensure consistent measurement and reporting across DNOs, to give greater confidence in data and enable more comparison going forward.

Q10. Do you agree with our proposed RPEs allowances? Please specifically consider our proposed cost structures, assessment of materiality, and choice of indices in your answer.

We do not have the visibility of the data as it was not published alongside the main document or appendices. We note that the idea of indexing RPEs was discussed in RIIO-ED1 and was ultimately rejected due to complexity. We do not believe the circumstances have changed and consider that this is more than likely to introduce costs to the sector by way of the supply chain. We are also concerned that this would introduce unnecessary uncontrollable risks. We also note that RPEs ties closely together with ongoing efficiency and that there is therefore a risk of double counting.

Q11. Do you agree with our proposed ongoing efficiency challenge and its scope?

We do not believe the data supports such an aggressive efficiency challenge of 1.22% on capex and 1.44% on opex. The CEPA report indicates this is above their plausible range. We note that a more plausible range on GO or VA measures is 0.4% to 0.8% and Ofgem have gone significantly higher than these estimates. We do not agree with these estimates and also note the risk of double counting with RPEs.

Q12. Do you agree with our proposed common approach for re-openers?

We agree that uncertainty mechanisms will have an important role to play in RIIO-2 where too much uncertainty exists to include costs and outputs in baseline allowance.

In this response, we make a number of initial observations in relation to the potential application of Ofgem's proposals for T2 and GD2 to RIIO-ED2. We expect the common approach to re-openers in RIIO-ED2 to be discussed as part of the SSMC process. It will be crucial that Ofgem step back to consider and assess the overall combined impact of these mechanisms, in particular the significant increase in regulatory burden for Ofgem and the licensees, as well the additional uncertainty that is created. We urge Ofgem to develop a re-opener framework for RIIO-ED2 which enables investment to progress at pace.

Application windows

In principle, we support bringing the application window for re-openers forward from May and shortening the re-opener window. We recognize the benefits this can bring by allowing more time for clarification questions and to allow more decisions to flow into the Annual Iteration Process (AIP) for that year. However, these benefits are only realizable if Ofgem also commits to a clear timetable for assessment and decision-making, supported by enough resource within Ofgem to enable fair, robust and timely decisions. We believe the specific proposals outlined by Ofgem are not practical for electricity distribution company planning resources. An application window in late January typically coincides with the winter storm season, with DNO resources at all levels prioritized on the safety and security of our network and customers' supplies. We propose Ofgem delay the application window to late February to avoid these hold ups.

We also have concerns with Ofgem's proposals to significantly reduce the application window. Ofgem must allow licensees companies enough time to prepare submissions, practically work through internal governance, and ensure availability of appropriate staff members. We propose Ofgem allow for a two-week application process, at least.

Application requirements

We have concerns about some of the proposed licence drafting on re-openers discussed at Licence Drafting Working Groups. In particular, we note that Ofgem are proposing to remove a number of the safeguards that are currently in place in the RIIO-ED1 licence as follows:

- Adjustments kicking in where Ofgem does not take action within a specified period of time: we note that RIIO-2 is a complex price control, with numerous mechanisms needing to be operated at any one time by Ofgem. Our concern is that companies will be faced with a choice either to delay investment, awaiting a final decision from Ofgem, or take on a significant amount of risk by progressing projects without Ofgem approval. There is also no longer a link between Ofgem decision-making and adjustments to revenue as part of the AIP.
- Company financial performance excluded from consideration under reopener mechanisms: it is critical to the integrity of the regulatory framework that Ofgem commit to assessing company submissions on their own merits, without consideration of wider company performance.

Ofgem must ensure that appropriate safeguards are put in place to ensure a fair and transparent process. We do not think that it would be appropriate for Ofgem to automatically apply the same approach to ED2 without further discussions and formal consultation.

Authority triggered re-openers

We do not agree that the Authority should have the opportunity to trigger re-openers at any point during the price control. This would have significant implications in terms of ensuring companies are allowed enough time to plan ahead and ensure that they have the right resources and information available. This is critical to ensuring fair and transparent decision-making on re-openers.

Materiality thresholds

We are concerned that the proposed approach to setting of the materiality threshold could lead to unfair and unjustified treatment in the application of re-openers across companies and be a detriment to consumer value in certain parts of the country. The design of the proposed threshold using the TIM incentive rate within the calculation will mean companies with a lower TIM incentive rate will be disincentivised from bringing forward legitimate re-opener requests in the interest of their consumers. This is an unnecessary second penalty for low baseline cost certainty which is harmful to consumers. It could also prevent some projects which could be subject to competition being taken forward, which could be harmful to consumers. We would therefore recommend a materiality threshold is set in absence of the TIM mechanism. We would welcome further discussion with Ofgem to agree an approach appropriate for electricity distribution.

Q13. Do you agree with our proposals on a materiality threshold, a financial incentive, a 'foreseeable' criterion, and who should trigger and make the application?

We support Ofgem's proposals not to include a materiality threshold for this re-opener. We believe this sets a clear framework which focuses on consumer value, rather than costs, which will have been set up-front in the price control baseline.

However, we think Ofgem should reconsider a financial incentive. We believe an incentive is required to reduce any hesitancy from network companies to transfer allowances that could potentially reduce the opportunity for RAV growth. We are concerned that Ofgem's proposals to allow network companies to agree commercial terms on the "compensatory value for this risk to be passed between them" may not work well in practice. We believe that this could lead to hesitancy on the part of the company taking on any new project from another company as a direct result of the potential for loss of TIM outperformance benefit obtained through the commercial agreement which is unlikely to be known at the design stage. As a reasonable alternative we propose CAM incentive mechanism could apply to the consumer value achieved as a result of identifying a whole system solution. The cost of the original solution compared to the cost of a whole system approach could be shared between consumers and participating networks. Assuming a 50% sharing factor, 50% of the total consumer benefit would be returned to consumers and the remaining 50% split between the participating networks. The party then assigned as responsible for delivering and constructing the whole system solution would continue to be subject to their company specific RIIO-2 TIM incentive rate for any efficiencies gained during construction, operations etc.

We support Ofgem's proposal not to include a 'foreseeable' criterion.

Q14. Do you consider that two application windows, or annual application windows, are more appropriate, and should these be in January or May?

We propose Ofgem allows for annual application windows as this will ensure solutions are only brought forward once both parties involved are ready. This will also avoid delays to connection infrastructure development, which could arise if two fixed application windows are used. It will also provide for better alignment with the RIIO-ED2 regulatory cycle and time for DNOs to bring forward projects.

We support an annual application window in May, which gives network companies enough time to assess financial positions after other company specific re-openers have been assessed. However, we urge Ofgem to lay out a clear commitment for their own assessment of projects through the CAM, including commitment to a two-month window to complete assessments and reach decisions. We believe this is necessary to avoid unnecessary delays to project and realisation of consumer benefits.

Q15. Do you consider that the RIIO-1 electricity distribution licences should be amended to include the CAM, or wait until in 2023 at the start of their next price control?

We see a number of circumstances where the introduction of the CAM licence condition into RIIO-ED1 could have benefits. Firstly, we note that there are a number of existing projects in RIIO-ED1 that are likely to require bespoke arrangements to cater for a whole system solution. These include:

- SHEPD financial contribution towards proposed electricity transmission links to Shetland to reflect benefits to distribution customers resulting from avoided reinforcement costs. We note Ofgem's statement in its December 2019 decision document[2] that any contribution would be "transparently and robustly implemented and would be subject to the formal licence change and code modification processes."
- Introduction of innovative whole-system solutions in RIIO-ED1: for example, our South West Active Network (SWAN) project which we introduced because the amount of Distributed Energy Resources connected and connecting to the distribution networks was believed by the ESO to be impacting on the transmission network.

We also note Ofgem's plans to introduce a new licence condition relating to whole systems. The parallel introduction of a supporting mechanism through the CAM licence condition could better enable DNOs to put forward whole system solutions.

We would welcome discussions with Ofgem on the extent to which the CAM licence could be an appropriate and effective tool for managing whole system approaches that are already being deployed in RIIO-ED1. However, the timing of the introduction of the licence condition will be key, as will be the need to ensure that the licence drafting is appropriate and caters for the scenarios we have outlined here.

Q16. Do you agree with our proposed re-opener windows for cyber resilience OT and IT, and our proposal to require all licensees to provide an updated Cyber Resilience OT and IT Plan at the beginning of RIIO-2?

We are supportive of re-opener windows for cyber resilience OT and IT. We believe it is prudent for network companies to be able to adjust allowances against the evolving nature of the cyber security threats. We additionally welcome Ofgem's proposal not to include a materiality threshold for this uncertainty mechanism.

We do not however support the use of only two re-opener windows. We believe annual re-opener windows are better suited to this allowance as this better allows companies to adjust to a rapidly-changing threat landscape. Additionally, we do not believe there should be a compulsory requirement for network companies to make a submission in any re-opener window. We believe this should be at the discretion of network companies. We do not recognize the argument presented by Ofgem that this is required due to the "fast changing and new risks/threats may emerge post Business Plan submission". We believe network companies are better placed to make this assessment and bring forward proposals at the right time.

Q17. What are your views on including the delivery of outputs such as: CAF outcome improvement; risk reduction; and cyber maturity improvement, along with projects-specific outputs?

We are supportive of the principles set out by Ofgem that these factors should be considered when assessing if the cyber resilience OT 'use it or lose it' allowance has been spent in a proportionate, appropriate and efficient way. We are working hard to improve our assessment against the CAF and we hope to be largely compliant before the end of RIIO-ED1. We see the CAF as a generic tool to ensure that we have management systems in place. As we develop our maturity in cyber-risk management, we are identifying areas of risk. These will not necessarily affect our self-assessment

[2] https://www.ofgem.gov.uk/system/files/docs/2019/12/20191217_shepd_contribution_decision_accessible.pdf

against the CAF but need to be addressed. We are supportive of the principles set out, but believe the focus should be on risk reduction rather than CAF outcome improvement.

Q18. Do you agree with our proposal for the Non-operational IT and Telecoms capex re-opener?

We are supportive of re-opener windows for non-operational IT and Telecoms CapEx. However, we do not support the use of only two re-opener windows. We believe annual re-opener windows are better suited to this allowance as this better allows companies to adjust to a rapidly-changing landscape, especially on open-data.

We urge Ofgem to adjust the timing of the re-opener windows to late February and to include a two-week re-opener period, at least. This allows companies time to practically work through internal governance and gives reasonable time to adjust in case of unavailability of key staff. Additionally, an application window in late January typically coincides with the winter storm season, with company resources at all levels prioritized on the safety and security of our network and customers' supplies.

Q19. Do you agree with our approach to using a re-opener mechanism for changes to government physical security policy?

We are supportive of the approach outlined to use a re-opener for changes to Government physical security policy. However, we also believe this allowance should cover physical security upgrades driven by applying enhanced cyber security measures, and would welcome specific additional guidance from Ofgem on this area.

We note Ofgem is consulting on materiality thresholds as part of Draft Determinations for transmission and gas distribution companies. We urge Ofgem not to automatically apply any thresholds to DNOs, but rather to consult separately for RIIO-ED2 to ensure they are proportionate to our needs.

Q20. Do you agree with our approach regarding legislation, policy and standards?

No, we do not support the approach adopted. We believe Ofgem has failed to properly consider the impact that changes in Government policy and legislation on post-Brexit trade tariffs could have. There is considerable uncertainty in this area during the time that the UK Government negotiates details of the UK's future relationship with the European Union and engages in new trade deals with other world countries. For some time and until new enduring trade arrangements are in place, network companies face the possibility of paying higher prices, due to temporary and permanent trade tariffs for costs of goods and materials sourced in global markets. These changes will not be covered within existing arrangements to account for changes to the prices in goods such as RPEs and inflation indexation. Nor in many cases do network companies have the option to change supply chains to other global locations or internal source quickly to avoid these impacts, often because the nature of the products we are purchasing is specialist, and we enter into longer-term procurement contracts with suppliers to yield economies of scale benefits for consumers. The sudden imposition of trade tariffs would be an exogenous change that could materially impact costs and we urge Ofgem to allow for a re-opener which is triggered upon changes to the UK's foreign trading arrangements being known. We believe such a re-opener can be subject to the same materiality threshold as others.

We note Ofgem's position not to consider re-openers for other (non- Brexit) legislation, policy and standards changes, notably related to environmental and technical standards. We urge Ofgem not to automatically adopt the same position for electricity distribution. We believe there are specific areas relevant to this sector which may be worthy of further consideration for re-openers in the context of RIIO-ED2. For example, this could include upcoming changes to SF6 regulations.

Finally, we would like to flag our concerns with Ofgem's rejection of SHE Transmission's proposals for a re-opener relating to wayleaves. Landholder compensation claims are largely outside company control and costs associated with these are increasingly uncertain. For example, we are now starting to see claims from commercial property owners and substation lease agreements are expiring, which can have a significant financial impact. Our preferred approach would be to enable companies to propose baseline allowances that are well evidenced and based on an understanding of existing cases, coupled with a re-opener or logging up mechanism to ensure companies are ultimately in a position to recover efficient costs. This is likely to be a significant issue in RIIO-ED2 and we are keen to engage with Ofgem early on in the process to ensure we agree an appropriate way forward.

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?

We share Ofgem's desire to make the "network price control regulatory regime more adaptive to deliver the most effective transition at lowest cost". Our view is that Ofgem must actively balance the interests of current and future consumers in its approach to Net Zero, recognizing that investment today will help keep bills low in the future, and resulting in lower costs to consumers overall.

Practically within the price control, the overall approach to meeting Net Zero should be about finding the right balance between ex-ante baseline funding and funding through uncertainty mechanisms as more certainty emerges. Several key considerations are important here: timeliness of investment decisions which meet the needs of consumers; the ability to maximise the opportunity for efficiency gains; and protecting consumers from stranded assets (including preventing against windfall losses for consumers and unjustified gains for network companies). Network companies are well practiced in achieving this balance by managing uncertainty and investing in network capacity which benefits all users, and there is substantive experience we can draw on.

In some cases, following robust assessment, there may be a clear case to invest now to accommodate capacity needs across several price control periods. In others, the case for investment may not be immediately clear at the start of the price control period but may become clearer over the period.

There may also be instances when investing in additional network capacity – even when there is a degree of uncertainty in the need – may still be the right decision when fully considering the customer impacts and broader societal costs of, for example, failing to meet demand for the electrification of heat and transport.

We are concerned that the RIIO-2 framework as it is emerging through the Draft Determinations shifts the onus on companies to wait until later in the price control period to secure funding, as new information emerges. We do not believe this is in keeping with the fundamental principles of meeting the needs of customers, maximizing efficiency or facilitating the transition to Net Zero, and recent findings from the Committee on Climate Change. The proposal for frequent re-openers is likely to be extremely resource and time intensive and create additional uncertainties: this may not be proportionate in the context of electricity distribution where we are less likely to see large individual projects being brought forward.

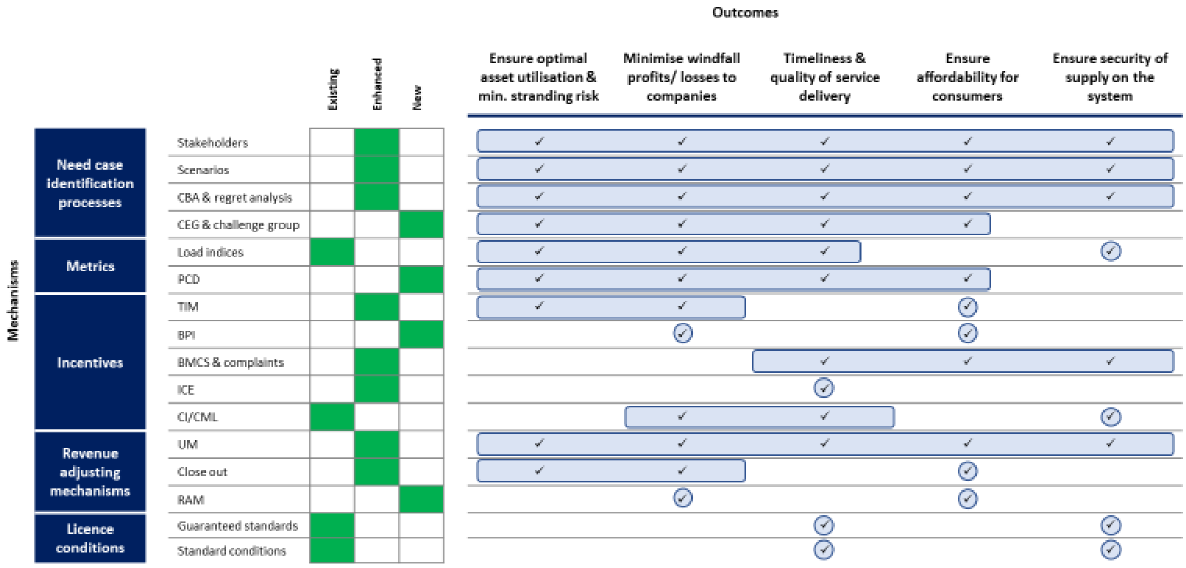
Striking the right balance must also recognise that many of our electricity distribution stakeholders are calling for these investments now, as evidenced through Local Area Plans. They are reliant on network companies making capacity available to allow for greater deployment of electric vehicles and other low carbon technologies. Many stakeholders are prepared to invest today and need strong networks with enough capacity to accommodate their growing ambitions. We believe that Ofgem is being overly cautious and should provide much clearer direction and guidance in supporting governments' Net Zero Carbon targets.

We further believe that Ofgem could draw more confidence from the information and mechanisms it has at its disposal when deciding if network companies can include more Net Zero funding proposals within the baseline. This includes recognising that uncertainty mechanisms should be symmetrical.

In the figure below we outline the multiple mechanisms that are currently in place to provide Ofgem with the tools to ensure proposed expenditure is prudent and efficient, and to ensure consumers' key outcomes are met when facilitating Net Zero Carbon. The figure highlights that there is more than a simple binary choice between baseline funding and uncertainty mechanisms, and that Ofgem has several tools and mechanisms which can all be used to protect consumers from inefficient investment decision-making.

We urge Ofgem to reflect on its approach to Net Zero by recognizing the demands of the market today and to take confidence in the tools it has at its disposal to protect consumers.

Multiple mechanisms ensure consumer's key outcomes are met when facilitating Net Zero



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?

The package of uncertainty mechanisms must be comprehensive and robust. It is also important to ensure uncertainty mechanisms are mutually exclusive in coverage as far as possible so that their use is well understood by all stakeholders. We are concerned that the Net Zero re-opener mechanism does not have enough scope definition and clear parameters of use to avoid unintended interactions with other mechanisms. For example, it is not tangibly clear which investments would go through the Medium Sized Investment Projects (MSIP) and Large Onshore Transmission Investments (LOTI) and which projects would go through the Net Zero re-opener.

We are additionally concerned about the over-reliance on re-opener mechanisms in general within the price control to facilitate Net-Zero, and whether this represents a proportionate approach in the context of electricity distribution. Our view is that for RIIO-ED2 there are circumstances where Ofgem could make greater use of volume driver mechanisms, using clear signals from existing processes to provide need cases for investment, for example incremental wider works on the electricity transmission system is much better suited to having a volume driver to using signals from the ESO's Network Options Assessment (NOA) process.

We are also concerned with the approach adopted post final submission by Ofgem to combine mechanisms into single approaches for all companies in a sector. We recognize the benefits having common designs provides, but we feel stronger signals from Ofgem could have been provided on the desire to see this approach adopted. We are concerned that the rushed approach to combining mechanisms adopted by Ofgem may not work for all consumers and could lead to unintended consequences. For RIIO-ED2, we urge Ofgem to provide early clarity on where it expects to see a common approach adopted and the potential applicability of regional adjustments.

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

We welcome Ofgem's recognition that achieving the most effective transition to Net Zero requires an adaptive regulatory regime. To be truly adaptive, any cross-sector mechanism must be able to respond to an identified need, regardless of the source, in a timely manner and in a way that recognizes regional differences and protects the integrity of the price control framework. We do however require clearer guidance on the parameters of use to avoid unintended interactions with other mechanisms. We also think that the mechanism should be capable of adjusting upwards as well as downwards. Furthermore, we urge Ofgem to provide enough flexibility to allow the mechanism to be triggered as and when required; and allow network licensees, not just Ofgem, to trigger the mechanism. Network companies are at the heart of designing and delivering these investments and have a close relationship with customers and understanding of their specific technical needs. Allowing us to bring forward proposals in a collaborative approach with Ofgem, and other stakeholders, will ensure proposals leverage our unique insights on network capability and customer needs, which will enable more efficient and cost-effective solutions to be developed.

We support the introduction of a Net Zero Advisory Group (NZAG) to provide increased strategic coordination between Ofgem, Government and key stakeholders. However, we believe that informed and effective development and implementation of Net Zero policies can only happen if network licensees, and their stakeholders, also have a role in the process, including a route to present, inform and influence the debate. We would like to explore with Ofgem ways in which we can ensure transparency, for example through ENA engagement. The group composition must also be suitably diverse with the right expertise to understand local issues. We urge Ofgem to reflect on the membership to ensure it represents the needs of consumers in remote and island communities, who are often most affected ny the largest infrastructure developments. This should go beyond including devolved authorities within the group membership.

We would welcome clarity on the role Ofgem anticipates NZAG will play in the Net Zero Re-opener decision-making process. We note the importance of ensuring the process remains transparent and enables timely decisions so that projects can go ahead without unnecessary delays.

Q24. Do you agree with our proposals for the RIIO-2 Strategic Innovation Fund?

We are broadly supportive of Ofgem's proposals for the RIIO-2 Strategic Innovation Fund (SIF). However, our view is that more information is required if we are to fully understand the potential impact of the mechanism and the extent to which it is likely to achieve the stated policy aim. We would expect to see more detail in a number of different areas as highlighted below.

Alignment with different public funding streams

We would welcome further information on how Ofgem proposes to achieve alignment with different public funding streams, especially in circumstances where other funding streams may have a different objective. There is a risk that working across different funding streams could result in conflicts between different funders' objectives.

For example, the existing NIA IPR arrangements which aim to ensure that network customers benefit from any IPR developed through NIA projects are not necessarily compatible with the objectives of other funding agencies specifically targeting the development of products and services which can then be commercially exploited.

A clear approach to addressing potential issues would be essential to keep projects efficient and delivering maximum value. The timings of various funding initiatives need to be aligned and coordinated to allow appropriate projects to be developed.

We note the introduction of a Net Zero Innovation Board. We would welcome further detail on the role of this group and on its composition. It is important that membership is balanced appropriately across geography and disciplines.

Timings and submission process

We would like Ofgem to provide more detail on the proposed processes and timings for bid development and submissions.

As we understand it, Ofgem's proposals is for bid windows to vary yearly, with the focus of each challenge to be defined as and when required. We would welcome clarity on the likely timings for the competition: this would allow companies adequate time to identify partners, engage with stakeholders, and develop high-quality submissions.

We also note that the proposed approach to setting different challenge each year, which may be broad and less well-defined, will likely have implications in terms of companies requiring more time to develop bids.

Finally, Ofgem has yet to provide information on other elements of the assessment process, including for example eligibility and assessment criteria.

Developing bids for the RIIO-1 Network Innovation Competition (NIC) is a lengthy and resource-intensive process, taking up to nine months and costing in excess of £150k. Ultimately, Ofgem's proposals for RIIO-ED2 could impact on the quality of the bids and the cost of their development. We will require further information from Ofgem in order to help maintain the quality of submissions, develop relationships with appropriate stakeholders and partners in a timely, and ensure our innovation proposals align with the new framework for RIIO-2.

Company contributions and recovery of funds

The current Network Innovation Competition (NIC) requires licensees to make a compulsory 10% contribution to the overall cost of a project. Ofgem is proposing that this contribution will vary under the SIF and will be considered on a case-by-case basis. We note the importance of providing sufficient clarity in a timely manner. This will enable us to plan in advance and ensure we are able to secure budget.

A new element of the SIF is that third parties will be able to apply directly for funding. Under current arrangements, funding is recovered through network charges, based on the concept that innovation funding will lead to an overall reduction in network charges and/ or improvement in services over the longer term. We would welcome clarity on the extent to which Ofgem envisages utilizing the same mechanism to recover funding from customers, noting that third-party funding may not ultimately contribute to a reduction in cost and/ or improvement of services for customers.

Independent administration of SIF

Further clarity is required around how the third-party responsible for administering the SIF will be appointed, managed, funded and held accountable.

We agree that the introduction of an independent third-party to administer the SIF is likely to have advantages. However, we note that it will be key to ensure that any differences in objectives between the SIF and the independent third-party, an any conflict of interests arising out of that are carefully managed. It is important that trust is created through an open, fair, and transparent appointment process, and maintained through careful management.

Bundling up of projects

Finally, we recognise that in some cases it may be more efficient to bundle different innovations projects into one larger project, to avoid unnecessary duplication. However, there will be circumstances where it is important to continue to allow different innovation projects on similar topics and issues to progress and receive funding. While, developing large single projects can assist Ofgem in their assessment of the proposal, it can add significant cost and complexity to the delivery of the projects especially if there are multiple partners and participants involved. It also places a significant additional burden on the project lead, who will be required to put in place appropriate collaboration agreements to deliver the projects, coordinate and align a wider group of participants and a larger number of work packages. This may lead to delays and generally slow the pace of innovation. There are good examples, such as the TEF projects where three projects on the same topic are being delivered individually but there is a strong collaboration to ensure that learning is shared and unnecessary duplication avoided. Similarly, there have been several innovation projects looking at Active Network Management (ANM), each looking at different components of ANM and its application.

There may also be different views on what the best way is to deploy innovative solutions. We firmly believe that plurality of thought should continue to be encouraged and will ultimately drive wider benefit for consumers.

Q25. Do you have any comments on the additional issues that we seek to consider over the coming year ahead of introducing the Strategic Innovation Fund?

Definition of innovation for the purpose of the SIF

When considering the definition of innovation to be used for the purpose of he SIF, we think it worthwhile taking into account the number of ways in which Net Zero can be supported. Delivering the network necessary to meet Net Zero will require accommodating increases in demand, resulting for example from EVs and the decarbonisation of heat, to be met through greater amounts of renewable generation. We note that the Committee on Climate Change have forecast a doubling of network demand (c.595TWh), which will need to be met by c.66% of renewable energy generation if Net Zero is to be delivered in the legislative timescales. Innovation will play a key role in accommodating this increase in renewables, through new construction methods, materials and processes. Where the level of risk is acceptable, our view is that innovation in these areas can be delivered through BaU. However, it is important to recognise that some innovations may involve a higher level of risk and therefore may not be delivered without additional innovation funding. The definition of innovation should be flexible enough to allow for these innovations to be included. The definition should also be flexible enough to allow for projects which consider wider benefits beyond the network, or do not produce direct benefits for DNOs and their customers but may result in wider societal benefit

Introduction of a single public sector energy innovation interface

We agree that there are likely to be benefits in having one portal for a single application that covers all possible energy innovation funding. We would be keen to help develop/test any ideas for such a portal to ensure an efficient process from an applicant's point of view. There are existing industry portals such as the ENA Smarter Networks portal, which allows applicants to propose ideas to electricity licensees, which are then reviewed via the ENA Innovation Managers group. Additionally, the ENA, EIC and SSEN have all run "calls" for applicants to propose ideas, which has resulted in the development of several successful projects such as TRANSITION, LEO and RaaS.

Source of funds for administration of the SIF

We recognise that there will be costs with identifying, appointing and then maintaining a third party to administer the SIF. There are obvious impacts if the source of this funding is to be included in the overall SIF pot or a percentage allocated to individual projects. Clarity is required around the potential allocation on an individual project basis, to enable us to adequately forecast project budgets for submission. Where the third-party administrator is running a number of funding mechanisms, administration costs must be shared proportionately.

Potential challenges for design-only early competitions

We are unclear as to what this refers to and would require further details in order to provide feedback.

Building on the existing joint gas and electricity innovation strategies

The current joint innovation strategy has been built up through strong stakeholder engagement and provides a strong starting point for addressing future challenges. We think it would make sense for Ofgem to use this strategy as a basis for feeding into BEIS's wider Innovation Strategy.

We note the potential for conflict to arise between different needs, for example that of a supplier/market participant and that of a demand user. Any such conflicts will need to be identified early, and where they cannot be resolved, transparency around how funding is being used to deliver specific benefits will be key.

Ensuring network companies' knowledge dissemination activities build upon and link up with innovation activities funded by other bodies

Requirements could be attached to funding provisions to ensure that findings associated with overlapping funding, can be disseminated jointly to shared stakeholders. Further requirements could include accounting for previous innovation in similar areas to ensure that previous work is not being duplicated. In order to facilitate this, each funding stream involved will need to introduce clear processes for sharing information around past innovation projects, including participants and lessons learned. We note that the ENA already has a programme of shared dissemination events in place, including conferences such as LCNI, forums and webinars. These are well attended and help facilitate coordination.

Q26. Do you agree with our approach to benchmarking RIIO-2 NIA requests against RIIO-1 NIA funding?

We agree with the proposed approach. However, we note that it has limitations. The amount of money requested in RIIO-1 was set based upon the challenges faced at that time, with a strong focus on connecting renewable energy. The challenges we now face requires a broader focus on supporting the transition to Net Zero through whole system approaches to transport and heat, as well as continuing to facilitate the connection of renewable generation. We also note there are regional differences which have emerged since RIIO-1 funding was allocated. In Scotland, we have tighter targets for phasing out new internal combustion engine cars (2032) and delivering Net Zero (2045). The devolution of power in the context of energy efficiency and heat will also lead to differences in approach, network impacts, and potential innovative solutions.

Q27. Do you agree with our proposal that all companies' NIA funding should be conditional on the introduction of an improved reporting framework?

We agree that provision of NIA funding should be conditional on the introduction of a suitable reporting framework. We have been involved with the ENA work that has looked to expand upon the previous framework developed by the Energy Innovation Centre. The framework is being expanded to capture NIA and will be further expanded, in time, to capture BaU innovation funding. Therefore, we would hope that the governance process will allow the benefits reporting framework to evolve as both Ofgem and licensees gain experience in its implementation. Further clarity on how Ofgem will consider and approve the framework being proposed would be welcomed to help ensure that it meets Ofgem’s requirements and allows adequate time for it to be implemented ahead of RIIO2

Q28. What are your thoughts on our proposals to strengthen the RIIO-2 NIA framework?

Funding arrangements

We agree that the NIA funding allowance should provided for the full price control period and not on an annual basis. This will help avoid peaks and troughs at the beginning and end of the price control and allow more flexibility in terms of scope of and timings of projects to deliver maximum return on NIA investments for consumers.

Scope of eligible projects

We do not fully agree with the proposed scope of eligible projects, as it is likely that certain types of innovation would not be captured and therefore are unlikely to go ahead. There may be innovations projects that do not directly tie in to the transition to Net Zero or consumer vulnerability that could nonetheless deliver significant GB-wide benefits in terms of improving the design, development, construction or operation and maintenance of the networks, ultimately reducing costs for all consumers. It is possible that these will not go ahead as BaU, where risks are too high and/ or benefits are unlikely to be achieved within the current price control

We also note that commercially available technologies would not be eligible for the NIA. We do not agree with this approach, as successful demonstration of an innovation in a particular location does not mean it will work everywhere. Industry structure, participants, legislation and commercial practices may vary in different locations, and understanding whether an innovation can work in a specific context will require careful assessment against all these parameters before BaU roll-out. This can involve a significant amount of work, and there is a risk that innovations may not be developed for GB application and value lost if NIA funding is not provided. For example, SSEN’s RaaS NIC project builds on an earlier successful demonstration in Sweden of the use of renewable and energy storage to maintain network integrity. The RaaS project looks to test additional technical functionality and most importantly the business models and commercial arrangements which will ensure that the techniques initially demonstrated in Sweden can be applied within the GB network environment.

Considering the impact of innovation on consumers in vulnerable circumstances

We welcome the new focus on innovation and customers in vulnerable circumstances. The framework in RIIO-ED2 must enable DNOs to do more to help the most vulnerable in society, ensuring no one is left behind in the transition to Net Zero and the economic recovery following COVID-19. Innovation will play a central role. Therefore, we are keen to ensure the regulatory framework leaves these options open, to be further explored following stakeholder engagement and review of the cost benefit case.

Increasing third party involvement and IPR

We agree that there would be benefits to industry providing clarity around IPR arrangements. As an industry we have learnt a lot about IPR over the RIIO-1 period and we also note the extensive work carried out by the Energy Innovation Centre (EIC) in this space. The publication of joint guidance by the ENA would allow certain parties to engage more fully with the NIA process. We note that, under current innovation arrangements, we already engage extensively with third parties.

Q29. Do you have any additional suggestions for quality assurance measures that could be introduced to ensure the robustness of RIIO-2 NIA projects?

We will require more detail on how this will work in advance of setting up any NIA projects, and would like to understand the likely consequences of not meeting quality assurance requirements. Finally, we believe that the quality assurance test will need to recognise that projected outcomes from projects are based on assumptions made in advance of any trials. The learning generated throughout a project may result in these assumptions having to be reviewed, which may impact on the outcomes which were predicted at the start of the project. In some cases, this may even lead to the project being stopped or amended to ensure that it still provides best value. Therefore, we believe that any QA should focus on quality of delivery and not necessarily on outcomes defined at the beginning of the project.

Q30. Do you agree with our proposals to allow network companies and the ESO to carry over any unspent NIA funds from the final year of RIIO-1 into the first year of RIIO-2?

We agree with the proposal. This will avoid the potential cliff edge at the end of the price control and allow companies to better account for any COVID impacts that have delayed existing projects. We note that this does represents a change in timing and not in allowance and therefore does not increase costs to consumers.

Q31. Do you agree with our proposal that all work relating to data as part of innovation projects funded via the NIA and SIF will be expected to follow Data Best Practice?

We agree that innovation funded through the NIA and SIF should follow Data Best Practice.

In order to put the recommendations of the Energy Data Taskforce (EDTF) into action, the Energy Networks Association (ENA), representing transmission and distribution network operators for gas and electricity in the UK and Ireland, has created a Data Working Group with further sub-groups formed to address specific aspects of the report. The Department for Business, Energy and Industrial Strategy (BEIS), Ofgem and Innovate UK have commissioned the Energy Systems Catapult to develop

Data Best Practice Guidance to help organisations understand how they can manage and work with data in a way that delivers the vision outlined by the Energy Data Taskforce.

As part of this collaborative approach we will continue to engage with stakeholders on use cases and data provision utilising a data triage process which presumes open data whilst maintaining cyber security and data privacy best practice. We are very conscious that categorisation of data, which should comply with data best practice guidance, must be driven by stakeholder and user needs and ultimately benefit a wider group.

We take an open-minded view as to who the 'users' of energy systems data might be and we recognise that users are likely to interact with many other systems, such as other utilities, finance, transportation and housing.

Q37. Do you agree with our overall approach regarding treatment of CVP proposals?

Our view is that Ofgem has overall not provided sufficient guidance to network companies on CVP proposals, noting that only a small number of proposals out of the 117 submitted are eligible for a reward.

We welcome the additional guidance provided by Ofgem as part of its updated RIIO-ED2 Business Plan Guidance. We would urge Ofgem to continue working with the DNOs to provide additional details and guidance on its expectations in a timely manner, so that this may be reflected in companies' stakeholder engagement and business planning processes.

We note that Ofgem has raised concerns around the methodology used by some of the companies to value their CVP. CVPs, by their very nature, are likely to be difficult to value using more traditional approaches. We would encourage Ofgem to work more closely with the network companies to agree on suitable methodologies that would meet Ofgem's criteria.

Q38. Do you agree with our proposed clawback mechanism to treat received CVP rewards?

We recognise the importance of ensuring that CVPs receiving a reward are delivered. However, we note that the introduction of reporting requirements and individual claw-back mechanisms could create disproportionate additional regulatory burden and add unnecessary complexity. We would like to see Ofgem considering an alternative, more proportionate approach given the size of the reward available, in line with Ofgem's previous agenda of simplifying price controls. For example, this could involve an on-going role for the CEGs and User Groups in holding companies to account.

We note that for RIIO-ED2, Ofgem has provided additional guidance on the minimum and maximum value of individual CVPs. We would welcome a discussion on introducing arrangements that are proportionate to the size of CVPs at both ends of the scale.

Q39. Do you have any views on the interlinkages explained throughout this chapter?

We agree with SHE Transmission's response to Q39.

In particular, we do not consider that it is a useful or appropriate exercise to attempt to enumerate or categorise the relationships in the abstract, particularly in advance of the Final Determination. We understand the term "interlinkages" in Q39 is referring to a legal concept developed in the decisional practice of the Competition and Markets Authority (CMA). In that context, the question of whether any interlinkage arises can only properly be assessed on a case-by-case basis in light of the specific flaws identified in grounds of appeal raised in respect of Ofgem's final price control decision. Moreover, it is clear that in certain cases an imbalance in the price control caused by a specific flaw in

Ofgem's decision can properly be corrected by a change to only one of a number of related aspects thereof. Whether any relevant interlinkages exist (in the sense used by the CMA in its decisional practice) and, if so, the consequences for any remedy that the CMA orders to correct Ofgem's decision is a matter for the CMA, and not Ofgem, to determine. In this connection we fully endorse the position set out in Section A of SHE Transmission's response to Q39.

Furthermore, while emphasising its misgivings about attempting to enumerate interlinkages in the abstract, we agree with SSE that certain examples put forward by Ofgem include claims which are unsubstantiated, lack clarity or do not capture certain relationships within the price control. In any event, as noted above, we consider these will need to be considered on a case-by-case basis in light of the Final Determination (once made). See Section B of SHE Transmission's response to Q39 for further detail.

Q40. Are there other interlinkages within our RIIO-2 package that you think are relevant to the three pillars identified in this chapter?

We note that SHE Transmission has identified in its response to Q39 a number of cases where it considers that Ofgem has failed to achieve the correct balance between the three "pillars" of the price control. Insofar as these matters affect SHE Transmission, we agree with its assessment. To the extent that there are interlinkages within the price control outside of those articulated by SHE Transmission, as noted in the response to Q39 above these would be a matter for Ofgem to raise on a case-by-case basis, in light of the specific flaws identified in grounds of appeal raised in respect of Ofgem's final price control decision. It is therefore wholly appropriate for SHE Transmission to reserve its position in the event of any appeal to the CMA in respect of any interlinkages that Ofgem may put forward at that stage. Similarly, Distribution's position is wholly reserved in relation to any interlinkages that Ofgem may seek to put forward in respect of any appeal of ED2 Final Determination, when received.

Q41. 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?

We disagree with this proposal on the same grounds as those articulated by SHE Transmission. Please see response from SHE Transmission to Q41 of RIIO-2 DD – Core Document.

Q42. Do you have any views on the proposed pre-action correspondence, including on the proposed timing for sending such to Ofgem?

We disagree with this proposal on the same grounds as those articulated by SHE Transmission. Please see response from SHE Transmission to Q42 of RIIO-2 DD – Core Document.

Q43. Do you think we need specific mechanisms in RIIO-2 to manage the potential longer-term impacts of COVID-19? If yes, what might these mechanisms be?

For our two electricity distribution licensees, the operational impacts of COVID-19 will be managed through RIIO-ED1. However, there are likely to be some impacts in a number of areas, for example on survey results. The longer-term impacts of COVID-19 will be felt in terms of ways or working, for example in how we manage faults and planned interruptions, and prioritise activities to support those in vulnerable circumstances. We will have a role to play in the green recovery, which might require exploring different approaches to delivering and funding activities, and providing greater support to our local communities. We expect these impacts and associated activities to be captured in our business plan, and our current view is that no additional mechanism will be required for RIIO-ED2. As the situation continues to evolve, we propose that this be kept under review by Ofgem as part of the RIIO-ED2 process.

NARM

NARMQ1. Do you agree with our proposals on the scope of work within each of the NARM Funding Categories and on the associated funding arrangements?

NARM funding categories

We are unclear on the extent to which companies will be judged on risk improvements resulting from investments where the primary driver is not risk improvement (point A2 in table 2). The proposals could create unnecessary complexity. An alternative approach where companies are held neutral to any risk improvements resulting from other drivers could prove clearer and simpler to administrate.

NARMQ2. Do you agree the funding adjustment principles and our proposals for applying funding adjustments?

We would be keen to explore with Ofgem how the NARMs proposals set out in Draft Determinations can be developed to apply in the context of RIIO-ED2.

Treatment of non-intervention risk changes

We agree with Ofgem's proposal to hold the companies neutral to reasonable levels of data cleansing changes. We would like further clarity from Ofgem on what constitutes reasonable levels of data cleansing in this context.

Funding adjustment

We note Ofgem's proposals are designed to ensure companies do not make windfall gains as a result of companies carrying out different activities from those originally in their business plans. We recognise the importance of protecting customers in these circumstances. We note that there may be reasons that mean large windfall gains due to changes in activities are less likely in the context of electricity distribution, for example the nature of the asset base (higher proportion of low cost, high-volume assets). We would welcome a discussion with Ofgem on the extent to which there are concerns around potential windfall gains being achieved in RIIO-ED1 in this manner, noting that savings may also be justifiably reinvested elsewhere.

Our view is that the NARMs mechanism must enable companies to make reasonable trade-offs, to ensure the best outcome for customers, and continue to incentivise companies to act efficiently or find innovative solutions.

We propose to work with Ofgem to find ways to address concerns in the context of RIIO-ED2, for example through proposed changes by the DNOs to the Common Network Asset Indices Methodology (CNAIM) for RIIO-ED2. The proposed changes in the revised methodology will further restrict the SDI activities and add further controls to inhibit the potential for windfall gains in the Distribution sector which is possibly missing within the other sector methodologies.

NARMQ3. Do you agree with our proposed approaches to calculating funding adjustments and to application of penalties?

We understand the concerns that Ofgem are trying to address through these proposals. However, we think that there are a number of issues that require careful consideration to ensure the mechanism continues to incentivise the right behaviours.

Firstly, the risk of one-way ex-post adjustments to unit costs introduces a moving target and could create uncertainty for companies. This will impact plans and strategies during the price control. We note that this represents a step-change from RIIO-ED1 and DPCR5 and a move away from the original focus on output delivery.

We welcome Ofgem's statement that companies should retain the full TIM benefit of any genuine efficiencies. However, the proposals do not provide sufficient information on how any such assessment will be carried out. We think Ofgem should take a proportionate approach, for example by focusing their assessment at asset class level. Our view is that the TIM already exists as a protection to customers and that no additional adjustments are required where outturn unit costs are lower than the original baseline unit costs, and companies can demonstrate that they have overall acted in the interests of consumers in delivering/ changing their plan. For RIIO-ED2, where under or over delivery is above or below a certain threshold or "deadband", we would be supportive of retaining an incentive, similar to that which currently exists in RIIO-ED1, where any justified over delivery relative to target results in additional funding and rewarded, whilst under delivery results in claw back and penalty if not justified.

We note that proposed ex-post adjustments to unit costs will only apply where outturn unit costs are lower than the original baseline unit costs. The mechanism is asymmetric and does not recognise that there may be circumstances where outturn unit costs are higher than the original baseline unit costs for reasons outside of company control. There is a risk that this will disincentivise companies from carrying out certain activities that would otherwise be in consumers' interests, in particular difficult but necessary replacements. This is less of a concern in RIIO-ED1, where the focus is on overall delivery, and increases in unit costs in one area are likely to be compensated through efficiencies and decreases in unit costs in other areas.

Finally, we note that the introduction of Return Adjustment Mechanisms (RAMs) is an additional protection against windfall gains that did not exist in RIIO-1, and should be taken into account in considering the design of the NARMs adjustment and funding mechanism.

NARMQ4. Do you agree with our proposals in regards to requirements for justification cases?

We note that there are a large number of mechanisms in RIIO-2 that are likely to require significant input from Ofgem and the companies during and at the end of the period.

Any requirements for justification of cases should therefore be proportionate, and we do not think that this should involve the provision of large amounts of detailed information, which would be inefficient and inconsistent with the RIIO framework and the original NARMs policy intent. The treatment for justification needs to be proportionate to the unit cost and volume of activity, in particular within the ED sector which is characterised by proportionately higher volumes of low-cost assets. Again, within the revised CNAIM for RIIO-ED2 there is significant information within the long term risk mechanism to provide indicative justification for asset intervention requirements, supported by the company's strategic investment policy to explain the investment by programmes or portfolios without fulfilling excessive justification requirements.

We welcome the early conversations we have had with Ofgem on a potential reporting mechanism for RIIO-ED2. We look forward to continuing to work with the ED2 team to develop a proportionate, robust and transparent framework for RIIO-ED2.

Gas Distribution

GDQ1 Do you have any views on our common outputs that haven't been covered through any of the specific consultation questions set out elsewhere in this chapter? If so, please set them out, making clear which output you are referring to

Ofgem are proposing to reward GDNs for exceptional customer service relating to planned interruptions, emergency and response, and connections work (section 2.23). In particular, Ofgem are proposing to:

- Use an average score, based on a six-month a survey trial during GD1.
- Introduce a deadband, so that only companies scoring above the upper quartile scores will receive a reward, with companies within the deadband receiving no reward.

We have concerns that the methodology proposed for setting targets is not appropriate and could result in the introduction of skewed targets for RIIO-2. It does not appear to drive the right behaviour and in particularly, targets will be affected by the current COVID-19 situation.

Furthermore, we do not fully understand the driving force behind this type of target setting and reward and penalty approach. There is a risk that companies will not actually be incentivized to improve performance beyond the deadband, and the approach is also likely to discourage collaboration amongst DNOs.

We would therefore welcome further clarity on the methodology Ofgem proposes to use to set the deadband range. Ofgem should also give further consideration to the correct trial period that should be used to define targets.

National Grid Electricity Transmission

NGETQ7. Do you agree that there is a need for a SF6 asset intervention PCD, and do you agree with our rationale for making this mechanism a PCD rather than a UM?"

We note Ofgem's proposal to reject the uncertainty mechanism proposed by NGET and the proposed introduction of a PCD. We would welcome further detail on Ofgem's rationale.

We would need to better understand the rationale behind both decisions to be able to comment definitively. However, there is logic to an uncertainty mechanism if this is related to the uncertainty of availability in the market of alternatives to SF6 switchgear at 275kv and 400kv. However, where there is certainty of availability, a PCD may be appropriate. We note the proposal regarding Insulation and Interruption Gas (IIG) leakage and specifically note the comments for 132kv assets and would suggest that this is consulted on in more detail for RIIO-ED2.