

BEAMA Response to Ofgem Open Letter on the next network price control review process

Dear Akshay

BEAMA represents manufacturers of electrical infrastructure products and systems from transmission through distribution to the environmental systems and services in the built environment, with over 200 members ranging from SMEs to large multinationals. We work with our members to ensure their interests are well represented in the relevant political, regulatory and standardisation issues at UK, EU & international levels. BEAMA member products provide a sustainable, safe, efficient and secure UK electrical system. We support our members in ensuring that the UK has a strong electrotechnical industry which is recognised as an essential part of modern society and brings invaluable economic, social and environmental benefits.

This e-mail sets out BEAMA's response to the four questions posed in your open consultation letter dated 29th September 2022 and is as follows:

Q1 - Do you have any views on the strategic issues we must consider in the development of the next price control review process?

There needs to be allowance for more investment ahead of need, which is proven to reduce the cost of Net Zero. With up to £7bn/year investment projected for electricity distribution networks alone (source – BEAMA Report on “Growing The Supply Chain For A Net Zero Future”), stepping up during RIIO-3, provisions in the regulatory investment cycles to accommodate this will ensure the supply chain will be ready to deliver. This conversation needs to start now to ensure supply chain planning for RIIO-3 delivery. This requires a willingness and an ability of all stakeholders to change the way they are working. At this stage, we do not need a wholesale change in regulation or policy but rather fine adjustments to mechanisms as outlined by BEAMA in its response to the Draft RIIO-ED2 consultation, much of which is re-stated in this response. What we need is a change in mentality **facilitated and incentivised by regulation**. Now network operators, regulators, grid users and technology providers need to take the lead in accelerating the futureproofing of the network. We are ready to engage in a permanent dialogue at national level and at local level to see what needs and can be done in the short and medium term to build the power system for a just energy transition as the supply chain will be a key enabler in realising the transformation of the UK energy system and regulation needs to support this.

Improving network reliability and resilience is seen as one key foundation for ensuring that customers see the benefits from network investment. However, disruption to the supply chain is not recognised as being a possible threat to network resilience. Ofgem should consult more widely on the supply chain risks to be addressed rather than simply react to the last incident. The BEAMA Report sets out volumes required to meet CB6. These exceed the ED2 allowances which seem insufficient according to our modelling. Modelling done by the Energy System Catapult (ESC) for BEAMA suggests higher volumes for primary reinforcement than identified by Ofgem. BEAMA strongly recommends that Ofgem works with all stakeholders to develop a comprehensive and widely agreed set of forecast volumes so that the deliverability of this investment can be fully understood.

During the ED2 drafting process Ofgem has asked each DNO to prepare their own investment forecast based on the various National Grid ESO annual energy scenarios. The draft determinations seem to have pushed much of the DNO forecasts into uncertainty mechanisms through the application of a blanket scenario. Whilst ED2 shows some volume increases, it is a stepping stone

towards the volumes required in ED3 to meet the sixth carbon budget. Greater guidance on the preferred energy scenario might have yielded better results. By applying a blanket scenario, Ofgem have removed from planning much of the regional variation that exists across the UK; urban or rural; coastal offshore wind hotspot or not.

Reducing the baseline allowances and moving these to uncertainty mechanisms may be seen as reducing risks for consumers but the underlying risk remains and is being transferred from consumers to the supply chain which must decide whether to invest in meeting uncertain future demand. Ofgem must have a concern about whether the supply chain will be able to respond to the future demand and with the speed required. Specifically, Ofgem must address whether the complete process from DNO submission to Ofgem, Ofgem approval, orders to supply chain, deliveries to DNO's based on normal or extended lead times will meet increases in demand for more LCT within the necessary timeframes. It should be noted that the report modelling used by the ESC in the BEAMA report was also based on the CCC Balanced Pathways Scenario.

The avoidance of risk by Ofgem tends to push volume drivers towards demonstrated need, not forecast need. Further, BEAMA concern is that individual metrics are taken in isolation and do not give a clear understanding of the total need for investment across a network. As you sum the investment across the network the issues of deliverability become more critical and may be missed if there is no overview. Ofgem appears to believe that the supply chain and the skilled resource for installations is completely elastic but this is not the case, especially when other countries are likely to be purchasing similar equipment from international markets and will respond best to countries providing long term signals.

Ofgem is placing a lot of trust in the ability of flexibility to offset the need for reinforcement. BEAMA supports the use of flexibility and is working with industry to develop supporting standards, products and platforms. However, BEAMA notes two concerns with this approach; there are many enablers that need to be put in place before flexibility can be fully utilised, including network charging and commercial models and secondly that flexibility cannot be used as a stop gap to defer reinforcement for a few years. There is little incentive for companies to establish a local flexibility market and recruit customers for a short-term opportunity. There needs to be an on-going (more than a few years) financial basis for flexibility that would justify companies offering the service and customers investing in taking up the option.

BEAMA members consider the use of a re-opener a necessary mechanism but would strongly prefer that BEIS, Ofgem and the DNOs form a clear view of how they intend to meet CB6 so that all parties could make clear investment decisions to meet the coming demands. BEAMA has argued that, even if Ofgem continue to hold back investment in ED2, there must be a significant increase in investment in ED3 and that Ofgem and the DNOs should be working with the supply chain now to prepare for this. OFGEM TOTEX forecasts shows a declining spend through ED2 followed by a significant ramp up in demand, this represents a poor understanding of the supply chain mechanisms.

The needs of the supply chain to deliver the right volumes of equipment, at the right time can be summarised as :

1. Planning
 - Planning is the cornerstone of any decision and this planning should look at the short-term (between now and 2024) and the medium-term (until 2030).
 - As the electricity eco-system of operators, regulators, grid users and technology providers we need to clarify the needs for building the power system for a Carbon Neutral UK.
 - We need to become more granular on what solutions we need and in what timeframe.

- Digitalisation plays a central role (information, observability, monitoring), but is challenging for 3 reasons
 - Cooperation TSO, DSO, Industries
 - Digitisation is not at the right pace
 - Data Interoperability is still an issue
- 2. Predictability
 - To facilitate supply chain investment
 - To encourage the right skills
- 3. Partnership
 - Let's create the partnerships and alliancing models
 - Can we move faster if operators and technology providers sit together and look at the how to provide the functionalities of the grid that we need tomorrow?
 - Can we discuss together with regulators how to remove bottlenecks fast, for example by a slick re-opener process and more digitalisation?

On environmental performance BEAMA call on Ofgem and the DNOs to agree on a common format for vendors to report their products' embodied carbon as part of their environmental reporting so as to minimise costs, improve product comparison and ensure fairness in any procurement process. Depending on the size of a BEAMA member organisation their ability to understand and measure their scope 3 emissions and to develop embodied carbon algorithms etc can be limited, it is therefore critical for OFGEM and the network industry to provide all the guidance and tools to facilitate this. BEAMA notes that DNOs are also calling for the supply chain to meet Sustainable Supplier Codes or codes of practices. As with Embodied carbon a common approach to a supply chain code would aid in the reduction of costs. BEAMA also support mid term reviews on environmental performance but would expect the reviews to be made public and for Ofgem to seek the views of stakeholders when they review the reports.

Despite all the recent u-turns the government has kept its commitment to the net zero target dates, which crosses over into the BEIS Net Zero review on growth creation, at an affordable cost with high energy security. Clarity on the direction of travel is critical.

Q2 - Do you have any views on the case for change we have outlined?

We agree that there is a case for change in terms of ongoing refinement of the RIIO-2 framework to address issues such as the penetration of distributed generation, greater levels of uncertainty in demand and generation, and the electrification of transport and heat, as well as changes in the overall energy mix. For example, the mix of outcomes that are incentivised may need to change with the potential for a greater focus on DSO activities and flexibility markets. However, we don't consider that a more fundamental shift away from RIIO is needed.

At its heart, RIIO is a flexible approach to network regulation which is built on the pillars of strong incentives for efficiency, a totex approach which provides flexibility between opex and capex type solutions, a strong focus on outcomes and associated incentives, and support for the innovation needed for the energy transition. A continued focus on outcomes and associated incentives well as efficiency and innovation seems the right approach. To move away from this would appear a retrograde step with potentially negative consequences for the ability to meet the challenges posed by the energy transition.

In terms of delivering at lowest cost to energy consumers BEAMA members are uneasy with a process where necessary network investment might not be funded simply because the justification has been done poorly and customers suffer the consequences. BEAMA members are also concerned that Ofgem is using a scenario with mostly hydrogen home heating. If government meets its intended targets for Heat Pump roll out, this would leave the networks poorly prepared for the necessary reinforcement and increase the use of re-openers and, as has already been stated, push risk away from the customers (in the short term) and towards the supply chain.

In terms of Totex benchmarking BEAMA note that Ofgem has chosen always to adopt the benchmarking tool that gives the lowest cost. This may be a desirable outcome for customers now but there is no clear engineering justification of this choice and real costs may well be higher, as may have been indicated by other tools. BEAMA members also have concerns that the cost impact of Covid, the war in Ukraine and the likely ramping up in international asset volumes will make historical cost data highly unreliable.

BEAMA agree with OFGEM's proposal to introduce a new Smart Optimisation Strategy (SOS) licence obligation and would welcome a wider review of the practical application of whole system thinking and how all stakeholders can be actively and appropriately engaged in this. To facilitate this there must be shared whole system models that different participants can access to understand the impact changes can have on them and other stakeholders. We will need a common basis for reaching whole system decisions.

Open data is a key enabler to innovation and business forecasting. It is encouraging that DNO's are now reacting to the open data policy and are publishing on their websites asset data which is valuable to the supply chain for supply chain business planning and forecasting although the quality of this data varies wildly and needs to be more consistent.

In terms of regulatory reporting BEAMA notes that in ED1 there was no consistency in reporting through the regulatory period and the data demonstrating how DNO's were performing against their allowances and outputs changed, it became less transparent and more inconsistent over the review period. BEAMA proposes that there should be some form of tracking of spend linked to network reinforcement and connection of LCT. How will tracking of spend and delivery against the CCC 6th Budget measured, how do we know if performance is above or below plan?

In terms of outturn performance metrics and RRE in general, and subject to further clarification from Ofgem, BEAMA members support the metrics. We have concerns about the ability of Ofgem to actively check the DNO figures and, for network visibility, it will require clear and non-ambiguous definitions of 'visibility'.

Q3 - Do you have views on whether the changes to the electricity or gas sectors mean that there is a case to consider alternatives to the approach taken in the RIIO-2 price control?

As noted above, we don't consider that there is a strong enough case for adopting a completely new regulatory framework but there may be elements of the alternatives which could be brought into the RIIO framework to ensure it can best meet the future challenges for the gas and electricity sectors.

There still seems to be an element of a wait and see approach to the deployment of hydrogen at a domestic level. As we approach ED3 clarity is needed over the difference in investment required for an electrically based heating system and a gas based heating system. If hydrogen is not the solution, this would put even more pressure on the step change required in ED3.

Q4 - Are there any broad frameworks or options that you think we should consider, including variants and alternatives to those we set out?

The alternative options all have some inherent weaknesses and the positive elements such as negotiated settlement for elements of business plans that can be captured through refinement of the existing RIIO framework. As an example, an alternative ex-ante regime, with a simpler target to improve opex efficiency, would represent a step back to early RPI-X price controls. Such an approach would not address potential capex-opex trade-offs or create an appropriate balance between expenditure and other outcomes that will be critical for the future energy system.

The issues with ex-post regulatory arrangements have been seen in Ofgem's application of ex-post reviews in the past. They raise stronger information asymmetry issues between network companies and Ofgem than ex-ante incentive-based arrangements which have been demonstrated to be effective in revealing information over time.

Kind Regards

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