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Dear Akshay

SSEN Distribution (SSEN-D) response to Ofgem consultation on Future Systems and Network Regulation

1. We welcome the opportunity to respond to Ofgem's consultation on Future Systems and Network Regulation. We are currently in the last phase of the RIIO-ED2 process, with Final Determinations (FDs) due to be published before Christmas 2022. Significant work will be required as RIIO-ED2 gets underway to ensure lessons are learnt from the process at an industry-level, with further opportunities to feed in to RIIO-ED3 design.
2. As an industry, our priority for coming price controls will continue to focus on meeting the UK Government's net zero target and ensure a long-term affordable and sustainable supply energy for all. This will require significant investment in the networks, over and above the £100bn Ofgem already approves across each regulatory cycle, and is an opportunity to drive long-term growth in the green economy. It is therefore critical to get the regulatory framework right to ensure that:
 - i) decisions are made that will benefit customers in the longer-term, striking the right balance with a short-term focus on reducing bills,
 - ii) networks are incentivised to deliver this investment efficiently and in a timely manner for customers; and
 - iii) decision-making is agile and stakeholder-led.
3. We consider that the principles of the RIIO framework provide broadly the right grounding for this regulatory framework. Output based regulation, allied with incentives has successfully driven significant year on year improvement in reliability and customer service for customers. In RIIO-ED1 alone, we have reduced the number of interruptions our customers experience by 11% in our SEPD network and 19% in our SHEPD network, and our customer satisfaction survey score has improved by 5% to date. As distribution networks seek to manage increases in demand and a climate crisis it is important that customers are clear on what outputs and service they can expect, and that the charges customers pay are linked to the level of service they receive.
4. The RIIO framework is a key component of a wider set of market structures, and we have yet to see Ofgem and the UK government set out a clear vision of how these market structures are to evolve into 2050 to deliver for consumers across GB, with clear roles and responsibilities. This is critical to understanding the necessary

steps and taking a coordinated approach to driving industry change and enabling industry to work towards a common goal. We are further concerned that the current approach to driving industry change is piecemeal and will lead to negative outcomes for consumers. For example, we are seeing significant changes being driven through Access SCR and a lack of policy clarity in other key areas such as DSO. Separately, we note Ofgem's intention to consult on potential fundamental changes to indexation of the Regulatory Asset Value (RAV), a cornerstone of the UK regulatory model. Yet this is not referred to as part of this wider consultation on the future of regulation. This is despite the Ofgem stating that it intends to consult on the treatment of inflation in January 2023. Inflation protections are critical to keeping costs lower for energy networks and therefore consumers than would otherwise be the case without inflation protections. Significant reform cannot go ahead without clear joined-up thinking.

5. We note that the last major overhaul of network price controls (the RPI-X@20 project) undertook a comprehensive review of the regulatory framework which took over 2 years of extensive consultation and input from network companies and stakeholders. This framework was specifically designed to meet the types of challenges outlined in Ofgem's open letter. We disagree that a move away from ex-ante regulation could reduce risk on network companies. The key challenge facing the sector is uncertainty. Consequently, we need to reach agreement with Ofgem and broader stakeholders on investment, based on the best information available at the time. A move to ex-post review of the decisions taken by network businesses increases risk and would likely result in reduced incentives to invest, as networks cannot control what connects to the network once investment is made. It also poses questions about what timeframe Ofgem would use to judge whether investments have been effective.
6. With the return to a five-year price control cycle, RIIO-3 is just around the corner, and opportunities to make significant changes to the framework are therefore in practice limited. Rather than embark of a fundamental review of the RIIO principles, which will sap time and resource from Ofgem and the industry:
 - a. at a time of significant change and challenge; and
 - b. noting the significant resource requirements that will be required to run the RIIO-ED2 price controls on all sides.
7. We therefore consider that this time is better spent adapting the existing framework – in line with option 1 in the open letter. There are four key considerations which must be taken into account when evolving the existing framework:
 - **Achieving an optimised whole energy system:** a clear strategic vision for the energy system of the future is required with a clear purpose for all key players including Ofgem and network companies. This is critical to delivering a fully optimised whole energy system.
 - **Addressing existing and well-known challenging policy issues:** industry has been working on a number of critical and challenging issues (e.g. losses, smart metering, and unsustainable regulatory distortions). However, in many cases, this work has not resulted in clear outcomes or been translated into the regulatory framework. Further details are provided in response to question 1. These policy areas must be addressed and must take priority.
 - **Making strategic investment work at distribution:** we simply cannot deliver net zero with the current approach to investment and we need to put local authorities or regional coordinators at the center of helping to shape longer term investment plans and agreeing needs cases so that DNOs can be building the network fit for 2050. Furthermore, as noted by Ofgem and BEIS in the Electricity Networks Strategic Framework¹ strategic investment is a key driver of long-term growth: *“government analysis suggests that reinforcing Great Britain's onshore electricity network to meet net zero could directly support an additional*

¹ https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1096283/electricity-networks-strategic-framework.pdf

50,000 – 130,000 FTE jobs by 2050, contributing an estimated £4-11bn of GVA for the UK economy as well as positive impacts on wider sectors.” Strategic investment must also take a wider view of investment required at local level including for example to enhance resilience (including of telecom and water as well as power networks) or enhance the environment.

- **More efficient price control review process:** The current price control process is now taking around 24-30 months, longer if appeals to the CMA are made. This is over half of the price control period. With 5-year periodic reviews, we need to slim this process down. There are some steady state activities such as asset replacement (which is by far the largest item of DNO expenditure) where focus can be on the overall approach followed, rather than scheme by scheme justification. Equally, while we have found the enhanced engagement process to drive significant benefits, in particular through the challenge provided by the CEG, it is unclear on how much value Ofgem places on the considerable effort made to engage with stakeholders to shape our business plans.
8. We acknowledge that there are differences emerging between energy sectors. The exact same framework may not be appropriate for all sectors – noting the ESO already has quite a different model. However, when looking at the challenges facing DNOs, we believe that adapting the existing framework is best way to incentivise efficient spend to deliver net zero and deliver a long-term and sustainable energy efficient that all can benefit from.
9. We have responded to specific questions below:

Question 1: Do you have any views on the strategic issues we must consider in the development of the next price control review process?

10. As we start RIIO-ED2 society faces challenges that are unprecedented in their scale and nature. It is critical that the regulatory framework that is developed for RIIO-3 is forward-looking and regulates for the ever-changing challenges we face and will continue to face over the next regulatory periods. The RIIO framework provides a strong basis for this, but we consider that RIIO-ED2 has not gone far enough in maximising opportunities to develop an agile, outputs and stakeholder-led framework.
11. In addition to the wider strategic considerations highlighted in the introduction to this response, we highlight the following strategic issues which will require consideration in RIIO-3. Lessons-learned from RIIO-ED2 should also be reviewed and feed into any more detailed and specific consideration for RIIO-ED3. This is particularly important as the challenges faced at electricity distribution level will be very different to those faced in electricity transmission or gas distribution:
- **Addressing existing and well-known challenging policy issues: these include long-standing issues such as:**
 - i) strategic investment;
 - ii) addressing network losses (which are undervalued by the system as a whole);
 - iii) smart metering;
 - iv) reviewing the regulation of IDNO and private wire networks to ensure the framework is fit for purpose and delivers value for money for consumers;
 - v) whole systems interdependencies, across other utility sector and beyond;
 - vi) the PSTN network switch off; and
 - vii) the accidental dependence of water, telecom, transport, and social care systems on distribution networks for their resilience.

We consider that effort is much better placed in resolving these issues, which will deliver significant benefits for customers.

- **Facilitating investment in net zero and resilience at a local level:** DNOs have a critical role to play within their communities, both in terms of facilitating a community-led approach to net zero, and ensuring resilience to climate change and its impacts at a time where society is becoming ever more reliant on electricity. The regulatory framework must recognise this critical role and the contribution the distribution networks will make to moving away from an over-reliance on fossil fuels, by enabling agile locally-driven investment.
- **Clear roles and responsibilities:** the RIIO-ED2 process has resulted in different approaches taken by DNOs in a number of key areas including support to those in vulnerable circumstances through to local authority engagement and support. Further work is required at industry-level, with Ofgem and with government to ensure roles and responsibilities are clearly defined and going into RIIO-3.
- **Digitalisation and whole systems:** digitalisation and whole systems are central to delivering a smart and flexible network and enabling participation in the energy system transition. We note that obligations have been introduced late in these areas in RIIO-ED2, with little analysis of implications for DNOs' plans or interactions with the cost assessment methodology. A clear framework must be developed as we transition into RIIO-ED2 and RIIO-ED3.
- **Role of stakeholder engagement in business planning and decision-making:** we consider that some of the approaches developed through the enhanced engagement process, in particular the Customer Engagement Group (CEG) and wider stakeholder engagement have been central in our ability to develop a robust and evidence-led plan for RIIO-ED2. However, it remains unclear how this information, and information provided by stakeholders through the call for evidence in January 2022 and in response to Draft Determinations have fed into Ofgem's decision-making process. A clear framework for how stakeholder views feed into decision-making will be critical going into RIIO-ED2 and RIIO-ED3, to ensure local drivers are well understood and reflected in investment decisions.
- **Striking the right balance between keeping bills low in the short-term and investing for the future:** Ofgem must ensure that the regulatory framework enables investment that will benefit consumers and reduce bills in the longer-term. In some cases, this will involve investing more in the present. The regulatory framework must also move away from taking a narrow view of efficiency to capture wider environmental and societal benefits.
- **Achieving the right balance of risk and reward: it is critical that Ofgem strikes the right balance of risk and reward:** For the regulatory framework to be optimised, it is important that Ofgem strikes the right balance of risk and reward. Ofgem is currently considering a potential move away from an inflation-linked model. It is necessary for Ofgem to undertake any review of this model and review of the future of network regulation simultaneously as a single piece of work, as any move away from an inflation linked model would fundamentally change the nature of regulation of networks. Rather than moving away from the RIIO model, Ofgem should utilise the opportunities for flex that the framework already offers, and evolve this by enabling agile locally driven investment.

Question 2: Do you have any views on the case for change we have outlined?

12. As already noted, we recognise the case for an evolution of the price control framework. We have provided views on each area for change which Ofgem has outlined below:

Process

13. We agree with Ofgem's view that the process is highly resource intensive and time consuming for all parties involved. This process was designed for an eight-year price control, and it may be considered that that is not proportionate for a price control lasting five years.
14. We consider that some areas of expenditure, e.g. asset replacement, may be more comparable from one price control to the next. The focus of Ofgem's scrutiny in these areas should be on process, rather than a detailed review of individual projects and investment cases. Investment in such areas should be governed by robust processes around data, optioneering and evidence in each price control. Developments in RIIO-ED2, for example Ofgem's proposed project looking at modernising data reporting, and the use of digital tools could support such an approach and provide confidence in DNOs' forecasts.
15. We are committed to continuing to embed stakeholder engagement into business as usual (BaU). We have fully embraced the enhanced engagement process, specifically the detailed stakeholder engagement and the challenge brought by our independent CEG. However, we do not see that this process has truly fed into Ofgem's decision-making, despite significant time and effort on all parts, including our stakeholders.

Structure and form

16. We are unclear as to what specific changes to structure and form may be required to further encourage whole systems thinking. Whole systems thinking is ultimately about the right processes, data exchange and engagement which networks undertake for system planning. That can be enabled and assessed under the current form of the price control.
17. We do consider that a change in mindset is required, in particular a recognition that whole systems thinking could result in increased costs in the shorter-term for the benefits of future consumers and/ or wider society. At the moment, we do not see this captured in Ofgem decision-making, as illustrated by Ofgem's proposed rejection in RIIO-ED2 Draft Determinations (DDs) of our Whole Systems CVP. The CVP was designed to facilitate broadband connections for remote communities by utilising our existing assets, but was rejected on the basis that costs should not be borne by DNO customers.
18. We note that previous reviews have also considered aligning price control review periods, but this would significantly increase the burden on Ofgem and stakeholders, and would not encourage whole system thinking beyond the energy sector.

Balance of risk

19. As highlighted in the cover letter we strongly disagree that a move away from ex-ante regulation could reduce risk on networks or customers. On the contrary, this will create significant uncertainty around how investment will be funded, drive up risk and financing costs for networks and likely result to delays in investment. This is the opposite of what we need if we are to deliver a long-term, affordable, and sustainable energy system. It will also only increase the regulatory burden on companies and Ofgem, detracting from other objectives.
20. We continue to have concerns in RIIO-ED2 about financeability and the balance of risk and returns whereby there are material financeability concerns on debt and equity. This has further worsened as a result of current market conditions and Ofgem must retain this as a critical element of any price control in line with its statutory duties. We continue to advocate that the cost of capital and financial parameters are set based on reliable and observable market evidence. This will ensure energy networks are able to attract and retain the investment necessary to deliver the transition to NetZero to the benefit of consumers.

Scope of network regulation

21. In the context of distribution, Ofgem has already started work on changes to governance arrangements for DSO. It is unclear how this interacts with this consultation; however, we note that there is a significant

opportunity in RIIO-3 to build on RIIO-ED2 and develop a clear model for locally led investment decision-making. This should build on the existing framework for Local Area Energy Plans (LAEPs) and Local Heat and Energy Efficiency Strategies (LHEES). Given the localised nature of distribution network we consider that this approach could deliver significant benefits and act as an enabler for local community growth and the delivery of local and national net zero ambitions.

Different types of uncertainties

22. It is important that the different challenges that are faced in different sectors are recognised through the price control framework, and we consider that the RIIO framework enables this. With gas and electricity distribution and transmission all facing different types of changes, the innovation and incentive aspects of RIIO remain vital, and the ability of these to flex will contribute to managing the different types of uncertainties faced by different sector participants.

Question 3: 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?

23. For the reasons outlined in response to Question 2, we support Option 1 from Ofgem's open letter. As already noted, we do not think there is currently a clear case for change, and we do not think there is sufficient time, ahead of RIIO-3 starting to properly carry out a full review of the regulatory framework.

Question 4: Are there any broad frameworks or options that you think we should consider, including variants and alternatives to those we set out?

24. We do not consider there are any other frameworks or options that should be considered, and as highlighted in response to Q2 we support Option 1 from Ofgem's open letter.

Yours sincerely

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