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The Association for  
Decentralised Energy

Combined Heat & Power  
Demand Side Services  
Energy Efficiency  
Heat Networks

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## DRAFT ADE Response | Ofgem Open Letter: Future Systems and Network Regulation | 19 October 2022

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### Context

The ADE welcomes the opportunity to respond to Ofgem's Open Letter on Future Systems and Network Regulation.

The ADE is the UK's leading decentralised energy advocate, focused on creating a more cost effective, low-carbon and user-led energy system. The ADE has more than 150 members active across a range of technologies, including both the providers and the users of energy equipment and services. Our members have particular expertise in demand side energy services including demand response and storage, combined heat and power, heat networks and energy efficiency.

### Overall Evaluation

The ADE fully supports Ofgem undertaking this review and we agree that serious changes will need to be adopted to facilitate the energy transition and compliment the future of system operators.

Over the course of working within the RIIO framework we have made the following observations:

- The RAB approach is not likely to be suitable for system operations focused on service provision and technology.
- The performance panel has been genuinely useful in making the ESO respond more meaningfully to stakeholder feedback.
- The ODIs are difficult to navigate and don't feel that meaningful to the broader price control.
- The approach to whole system stuff is far from ideal currently. For example, the whole system CBA hasn't been used yet nor has the Coordinated Adjustment Mechanism. It is also probably hard to do both without further development of the approach to more strategic investment. Furthermore, it can't currently look across to hydrogen and heat networks effectively.
- The importance of RIIO to flexibility has been interesting. On the one hand, the DNOs put in place Flexibility First commitments well ahead of RIIO-2 which shows that the price control can respond to events but on the other, it's been a struggle to get this right and still suffers from lack of incentivisation.
- Past decisions on anticipatory investment may have been appropriate for the time but the impacts on connections in the long term have been negative, especially at the distribution level.
- While stakeholder engagement in the process of devising the price controls has been good, the actual controls are extremely complex (both in detail and how the whole design interacts) and hence there's a limit to how far engagement can be meaningful for some aspects.
- The price controls do create competition and some diversity of approach which has led to positive results in some areas. However, a lack of coherency amongst DNOs poses serious

barriers to participation for many actors and the emphasis on standardisation must be intensified.

## **1. Do you have any views on the strategic issues we will face in the development of the next price control review process?**

The ADE considers the following issues are of particular strategic importance going forward:

- Network companies, both now and under future price controls, will be expected to engage with far more stakeholders than before. Increased market participation demands increased accountability and transparency from the companies who set and run the markets that facilitate network operation.
- Network companies' visibility over thousands of distributed assets and ability to incorporate new assets at speed will be crucial.
- The relationship between transmission and distribution companies will become increasingly important. This is so especially with regard to how the market driven areas of network companies relate to the system operator functions. For example, although the Open Networks programme is currently considering primacy rules across services, this work is highly complex and not seen as totally transparent.
- It is likely the next price control will need to be far more dynamic to change and adjustment. Therefore, the number of reopeners and mechanisms for triggering them will likely steeply increase, making the process cumbersome.
- As above, while attempts have been made to coordinate whole system thinking across networks this work likely needs more fundamental change, especially how networks are going to incorporate newly regulated networks such as hydrogen and heat networks.

## **2. Do you have any views on the case for change we have outlined?**

We agree with the areas of change outlined. In particular:

- RIIO as resource intensive and giving an information advantage to network companies:
  - o The ADE strongly agrees that the current process favours parties with greater capacity for engagement.
  - o While this includes network companies it also includes larger companies who can dedicate resources to regulatory engagement and understand license conditions and price control methodologies in greater depth than most.
  - o As a greater number of decentralised energy actors join the industry, the profile of affected stakeholders will necessarily change and this needs to be accommodated for.
- Structural changes to reflect whole-system needs:
  - o We agree that the current sector specific approach can obscure the need for whole system outcomes.
  - o We appreciate efforts to adjust this during the RIIO-2 period with the introduction of whole system LOs for both the ESO and DSOs.
  - o However, it is unclear whether such inefficient outcomes are a direct corollary of the RIIO framework as opposed to the natural structuring of businesses into discreet segments. More investigation is needed as to how a change to the price control would instigate a cultural change within network companies.
- Reducing focus on strong ex-ante incentives:
  - o It is not evident that the ex-ante incentives are necessarily the basis of some of the problems with the price control frameworks as they stand.
- Impacts from the creation of the FSO:

- It seems undeniable that the creation of the FSO will entail changes to the price control, as should any similar outcomes from the review of local area energy governance arrangements.
- While the Energy Security Bill provides for the Secretary of State to provide funding for the ISOP, this is not currently drafted as a mandatory power

### **3. Do you have views on whether the changes to the electricity or gas sectors mean we should consider alternatives to the approach taken in the RII0-2 price control?**

On the options outlined, the ADE has the following considerations:

- Continued use of periodic reviews, with RII0 being adapted where appropriate
  - It is unlikely that a steady progression will be sufficient to answer the challenges listed above.
- Ex-ante incentive regime based on a simpler target reviewed only as and when necessary:
  - While simpler targets are preferable in some ways, and could aid in making the price controls less complex, the risk of reduced certainty surrounding what is actually expected from network companies would be very high.
- Ex-post regime where allowances are set based on a pre-determined rate of return:
  - It is unclear how such a rate of return would be quantified for whole system results. Even so, such a change would be interesting to explore further.
  - In particular, a mechanism to assess efficient network planning and deferred or avoided reinforcement would incentivise whole system thinking.

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#### **For further information please contact:**

Sarah Honan  
Policy Manager  
Association for Decentralised Energy  
[Sarah.honan@theade.co.uk](mailto:Sarah.honan@theade.co.uk)

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