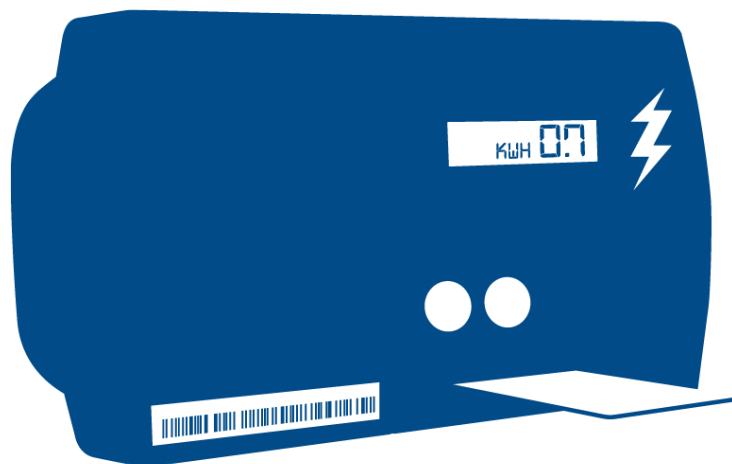


# Citizens Advice response to the Ofgem Open Letter on Future Network Regulation



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# Introduction

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We welcome this opportunity to respond to this Open Letter on Future Network Regulation. The energy infrastructure of the nation is a critical part of the transition to net zero and has a special significance as it underpins the ability for everyone to conduct their daily lives. Every pipe, wire, and transformer is paid for by the nation's consumers. It is therefore necessary that the framework for delivering the energy infrastructure that we need for now and for the future is effective and cost-efficient. It is vital that the regulatory framework is fit for the future and can respond to the changes that are underway, and those that will continue to evolve as new technologies or processes emerge.

In anticipation of a review of network regulation, we commissioned research into alternative regulatory frameworks. This research revealed a range of opinions and solutions, and we have used this information, and our own experiences of the current regulatory framework, to inform this consultation response. While the 'RIIO' framework was largely viewed positively, there were many suggestions for improvements. We have outlined below our 8 key recommendations for the government and Ofgem to ensure that the regulatory framework is fit for the future.

We recommend that Ofgem reads our short report on '[Future Network Regulation: Delivering a regulatory framework fit for the future](#)'<sup>1</sup> as this provides an overview to our thinking and recommendations. The [full report from Delta-EE](#) gives the varying views, solutions, and rationales that were explored in reaching our conclusions.

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<sup>1</sup> Citizens Advice, [Future Network Regulation: Delivering a regulatory framework fit for the future](#), October 2022

# Our 8 recommendations

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## **1. Government should give more clarity on priorities to Ofgem via its intended revised Strategy and Policy Statement (SPS)**

The government should provide a clear direction to Ofgem through a revised SPS which meets the needs of the net zero transition, ensures that consumers are at the heart of decisions, and that the most vulnerable are supported. A strong net zero focus would guide Ofgem's strategic planning and enable Ofgem to better balance priorities such as meeting net zero goals while minimising costs. A clear steer would assist in driving earlier strategic investment and provide more certainty for network companies and third party infrastructure investors.

## **2. Government needs to provide an overarching strategy for supporting customers, especially those in vulnerable circumstances**

The government should address the way that customers are supported. There is currently no clear strategy on how consumers are given financial support for bills, for low carbon technology improvements, or for energy efficiency measures. Nor is there clarity on how energy advice should be funded or which bodies should deliver it. This lack of clarity has meant that Ofgem has used the price controls to facilitate network companies to undertake a wider set of activities beyond supporting customers in an outage. These wider activities include providing energy and debt advice as well as other direct energy support. All of these activities are funded in a regressive way via bills.

A strategy is needed from the government that addresses how such activities are funded and delivered, including consideration of the role that welfare benefits can play. It is evidently preferable that targeted financial support for vulnerable people should be funded in a progressive way, e.g. via taxation, rather than added to bills. We recommend that our energy advice discussion

paper, 'Tackling gaps and overlaps'<sup>2</sup> is reviewed which provides recommendations and insights.

### **3. Ofgem needs to ensure that the regulatory framework works more effectively**

The regulatory framework needs to dovetail effectively with the other reforms underway in retail and wholesale markets, such as the Department of Business, Energy, and Industrial Strategy's (BEIS's) Review of Electricity Market Arrangements (REMA).

Whole-system and cross-sector thinking needs to be incorporated and rewarded within the price control process to ensure coherent and overall cost-effective solutions are implemented. Sectors that have considerable strategic overlap include the electricity transmission and distribution sectors, the Electricity System Operator and Distribution System Operations, gas and electricity, and across water, waste, heating, and transport.

### **4. Consumer and stakeholder views have to be better incorporated within the process**

At present, it is unclear how Ofgem makes use of consumer views and which areas it is seen of most relevance to. The ways of collating and using consumer views needs to be improved so that Ofgem has confidence in applying their message into decisions. We recommend that Ofgem:

- Is prescriptive how consumer engagement is carried out by networks and/or carries out centralised research and is clear where it is seen as most relevant
- Establishes a Network User Expert Advisory Group to provide expert stakeholder input during the price control period to provide expert input into detailed reporting requirements, guidance documents, and investment and uncertainty mechanisms

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<sup>2</sup> Citizens Advice, [Tackling gaps and overlaps: a discussion paper addressing the energy advice challenge](#), April 2022

- Continues a version of Customer Engagement Groups (CEGs) during the price control period to provide consistent challenge to company decisions and monitor implementation of business plan commitments

## **5. Flexibility has to be built into the regulatory framework to cope with a rapidly changing environment**

The current 5 year periodic price controls used in the RII framework lack sufficient flexibility to cope with rapidly changing environments in energy technology, and evolving net zero goals and initiatives. The periodic price control process also leads to a focus on short time scales, when the challenges that are faced require longer-term thinking. We recommend that other ongoing models, such as adaptive planning, are considered to frame long-term and strategic goals, with flexibility to meet shorter-term changes. Other elements of the price control, such as cost of capital considerations, might be better suited to a negotiated settlement process which may bring consumer and stakeholder views to the fore. An ongoing and strategic price control process should be more streamlined, efficient, and enable earlier investment.

## **6. Inefficient, time-consuming, and costly processes need to be reformed**

Network companies and stakeholders have commented upon the cumbersome, slow, and costly process of price controls. There is a substantial volume of material to produce (for the companies), and to read and understand (by the regulator and stakeholders) to be able to meaningfully input to the price control exercise. The impacts of the current shortcomings in the process include high costs in resources allocated to the task, a lack of appropriate input by some stakeholders (particularly by those groups without the resource levels necessary), a lack of comparability between business plan material, and likely poorer overall decision-making. We recommend that Ofgem makes the process simpler, cheaper, and more readily accessible for consumers and stakeholders by:

- Focusing on consumer outcomes as the goals to drive the right strategies and processes

- Being prescriptive in the information that is required from network companies in the business planning process
- Ensuring that the information is consistent, simply presented, available to all stakeholders, and that will enable ready comparison across companies or sectors

We address the resource imbalance issue at recommendation 8 below.

## **7. Improved and rigorous performance reporting needs to be built into the regulatory framework**

Network companies do produce some annual or periodic reporting that is required by Ofgem, such as reporting on stakeholder engagement or vulnerability support activities. Companies also voluntarily publicise some of their activities and whether they are meeting business plan commitments. Some companies have specific stakeholder groups where they discuss performance although there is no consistency across the sector in what is presented or how challenge is made to performance shortcomings.

Ofgem receives information on certain performance metrics from network companies and produces an annual report. For example, for the electricity distribution sector, Ofgem issues a 13 page RIIO-ED1 Network Performance Summary<sup>3</sup>. These reports could be described as ‘bare-bones’ with minimal information and a lack of qualitative comparative performance scrutiny.

As such, consumers, who are paying for all of these activities, have no method of consistent and thorough independent performance monitoring to ensure delivery of business plan commitments, and ongoing implementation of best practice measures across the sector.

Ofgem needs to build in rigorous, independent, transparent, and thorough annual performance reporting into the price control process. This could be achieved by Ofgem internally, or via an external, independent body. We recommend that key areas for consumers would focus upon reliability, connections, customer satisfaction, environment and sustainability, and

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<sup>3</sup> Ofgem, [RIIO-ED1 Network Performance Summary](#), March 2022

vulnerability support. However, we recommend that stakeholder and consumer research be undertaken to better design this performance reporting.

## **8. The information and resource asymmetry between network companies and other stakeholders, including the regulator, needs to be addressed**

Network companies have a considerable commercial incentive to invest resources (time, personnel, consultancy fees, etc.) into the price control process and have the financial ability to do such investment. The regulator has fewer resources, and there is a clear knowledge imbalance between network companies and an arms-length regulatory body. Other stakeholders, including ourselves, are in an even more disadvantageous position with even fewer financial and personnel resources to contribute to the process.

There are clear risks for consumers in this situation as:

- Companies' commercial incentives may not align with consumer interests
- Stakeholders may not have their voice heard
- Discussions can be influenced by the weight of arguments from sizeable network company teams using expensive consultancies

The impacts for consumers include key interests not being taken into account and poorer overall decision-making by the regulator.

A simpler price control process (recommendation 6) and more consumer and stakeholder input (recommendation 4) will help to address some of the imbalance. However, we recommend that a review is undertaken to identify imbalances between network companies, the regulator, and other stakeholder groups. Consultation could provide input to determine how best to redress the asymmetries in resources and knowledge which influence price controls, and appeals made to the Competition and Markets Authority (CMA).



# Questions

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

We agree with the key strategic features that have been outlined in the consultation, namely the increasing pace of transformational change, the need for whole-system thinking, and increasing importance of managing uncertainties. However, we highlight below a number of additional strategic issues and challenges that will be relevant to the development of a regulatory framework for energy networks.

### **Additional strategic issues to be taken into account**

#### **Retail and wholesale market reforms**

There are a number of reforms likely to take place in the retail and wholesale markets. For example, REMA<sup>4</sup> may lead to increased participation in flexibility by consumers. Any new regulatory framework for energy networks will need to ensure that it works effectively with these reforms to gain optimal benefits for consumers.

#### **Economic climate**

The economic climate that faces consumers in the coming years may have implications for the development of the energy infrastructure. It seems clear that there will be ongoing financial pressures facing businesses and households

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<sup>4</sup> Citizens Advice, Blog '[REMA — what is it and how it can deliver for consumers](#)', October 2022, and Citizens Advice, [Response to the BEIS consultation on the Review of Electricity Market Arrangements](#), October 2022

in a high inflation environment exacerbated by the potential for an austerity response from the government. The impacts are likely to be:

- Reduced demand for energy requiring revised forecasts and network planning
- A higher need to support customers in vulnerable circumstances, or who have affordability concerns
- A stronger focus on optimal solutions, looking to whole-system thinking, innovation, and a potential reconsideration of priorities

### **Support for consumers, particularly those in vulnerable circumstances**

A key case for change would be to clarify the support for consumers in the energy transition, and support for those in vulnerable circumstances. It is reasonable that support for vulnerable consumers suffering an outage is designed and managed by an energy network and funded via a price control process. However, it is far from clear that providing additional support, such as fuel poverty or energy transition advice, should be undertaken by energy networks and funded via bills. The current lack of clear guidance has meant that Ofgem has permitted or encouraged a wider scale of advice and support provision and in a piecemeal manner, network by network. This is funded in a regressive way via bills. We have stated in our key recommendations that the government should clarify how such support is funded and delivered. Such clarification would provide guidance to Ofgem and the energy networks in what work is needed from them to support consumers, and what should be funded from bills.

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

We agree that there is a case for change given the context of the strategic issues laid out in the consultation. Further to this, our research<sup>5</sup> provides evidence of

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<sup>5</sup> Citizens Advice, [Future Network Regulation: Delivering a regulatory framework fit for the future](#), October 2022

issues with how the current price control regime is operating to support the case for change.

## **Process**

Network companies and stakeholders have commented upon the cumbersome, slow, and costly process of price controls. There is a substantial volume of material to produce (for the companies), and to read and understand (by the regulator and stakeholders) to be able to meaningfully input to the price control exercise. The impacts of the current shortcomings in the process include high costs in resources allocated to the task, a lack of appropriate input by some stakeholders (particularly by those groups without the resource levels necessary), a lack of comparability between business plan material, and likely poorer overall decision-making. We recommend that Ofgem makes the process simpler, cheaper, and more readily accessible for consumers, stakeholders, network companies, and for regulation by:

- Focusing on consumer outcomes as the goals to drive the right strategies and processes
- Being prescriptive in the information that is required from network companies in the business planning process
- Ensuring that the information is consistent, simply presented, available to all stakeholders, and that will enable ready comparison across companies or sectors

Improvements to the efficiency of the process should not be at the expense of the degree of scrutiny applied to network company plans. We should be aiming to deliver robust assessment as efficiently as possible, not reducing costs by being less rigorous. The potential cost to consumers of mistakes in setting price controls is an order of magnitude higher than the cost of scrutinising price controls thoroughly. The aim of improving the process is to allow more parties to engage and so should enhance the assessment process.

## **Balance of risk**

We agree that judgements on the allocation of risk have predominantly turned out in favour of the network companies. Our research found a general view that

incentives targets are set too far in advance and have historically not been stretching enough.

### **Consumer and stakeholder engagement**

Our research has highlighted a number of issues regarding consumer and stakeholder engagement:

- Stakeholders do not have sufficient resources to meaningfully engage in the complex regulatory process
- End consumer engagement is not specific enough and research methods can yield misleading results
- It is unclear how the engagement findings are utilised by the network companies and by Ofgem

### **The information and resource asymmetry between network companies and other stakeholders, including the regulator, needs to be addressed**

Network companies have a considerable commercial incentive to invest resources (time, personnel, consultancy fees, etc.) into the price control process and have the financial ability to do such investment. The regulator has fewer resources, and there is a clear knowledge imbalance between network companies and an arms-length regulatory body. Other stakeholders, including ourselves, are in an even more disadvantageous position with even fewer financial and personnel resources to contribute to the process.

There are clear risks for consumers in this situation as:

- Companies' commercial incentives may not align with consumer interests
- Stakeholders may not have their voice heard
- Discussions can be influenced by the weight of arguments from sizeable network company teams using expensive consultancies

The impacts for consumers include key interests not being taken into account and poorer overall decision-making by the regulator.

A simpler price control process (recommendation 6) and more consumer and stakeholder input (recommendation 4) will help to address some of the imbalance. However, we recommend that a review is undertaken to identify imbalances between network companies, the regulator, and other stakeholder

groups. Consultation could provide input to determine how best to redress the asymmetries in resources and knowledge which influence price controls, and appeals made to the Competition and Markets Authority (CMA).

### **Value for money**

Separate to this research, we have previously highlighted that the allowed return on investment for network companies has been consistently too high<sup>6</sup>. The National Audit Office reached a similar conclusion in its report into the value for money of electricity networks<sup>7</sup>. To stop this happening, how regulators calculate the allowed return on investment, and the approach to setting targets, need to evolve.

## **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 RIIO-2 price control?**

In anticipation of a review of the RIIO price control system, we commissioned research from Delta-EE to consult with 16 key industry, academic, and consumer organisations. This research considered what has worked well in the RIIO price control process and where improvements should be made. You can read our [full research report](#) and also a [shorter summary report](#) on our website<sup>8</sup> which provides our key findings and recommendations. We have reiterated our recommendations within this consultation response for the appropriate questions, but would point to the wider discussions and case studies within the full research report which may be relevant to understanding advantages and disadvantages of alternative models and the reasons for their evolution. For instance, the research contains a case study on the adaptive planning model

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<sup>6</sup>Citizens Advice, [Monopoly Money](#), May 2019

<sup>7</sup> NAO, [Electricity Networks](#), January 2020

<sup>8</sup> Citizens Advice, [Future Network Regulation: Delivering a regulatory framework fit for the future](#), October 2022

proposed by Ofwat for PR24, and the New York Reforming the Energy Vision (NY REV) model which aims to increase the use of flexible resources in the energy system.

We agree with our research participants that the current RIIO model has many positive elements as it has managed to permit large scale investment in a changing environment. There are, however, a number of drawbacks to the current price control process, not least that, as this consultation recognises, the balance of risk in price controls has favoured the network companies - at a cost to consumers. When adding in the rapidly changing and uncertain development of the energy system, it is clearly necessary to consider alternatives to the approach taken in the RIIO-2 price control. These need to address the current issues with the RIIO framework alongside expected future issues.

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

It would be sensible to retain those elements of the RIIO price control that have worked well (and are expected to continue to do so) and enhance or replace those elements that have not served consumers as well.

Alternative approaches are likely to be suitable for different elements of future regulatory settlements. Some of the options outlined in the consultation, and those explored in our research, can be combined so the RIIO approach evolves to be fit for the future. We agree that a one-size-fits-all model may no longer be appropriate.

### **Alternative models and their merits**

In looking at alternative models to use or incorporate for parts of a new RIIO framework, we favour those models that enhance consumer and stakeholder engagement, are adaptable to changing environments, and have longer-term

strategic thinking built-into it. While our 3 case studies show alternative approaches that may have benefits, some are as yet unproven in practice (adaptive planning for PR24), have been slower or more complicated to implement than desired (NY REV), or may not be able to encompass the complexity and changing circumstances of the energy sector (Scottish Water negotiated settlements). However, we do believe that there is merit in considering where alternative models may be suitable for some elements of the price control (e.g. negotiated settlement may be useful for cost of capital and returns assessments, and NY REV may have lessons for driving improved take-up of flexibility resources). The alternative model with most promise appears to be the adaptive planning model with its longer-term focus, and built-in methodologies for amending the price control on an ongoing basis.

### **Consumer and stakeholder engagement**

A far greater emphasis on the value of consumer engagement can be achieved by leveraging the concepts embedded in a negotiated settlement approach. The RII price control process as it stands could be much improved in terms of consumer and stakeholder engagement by improving the methodology. As we have previously mentioned, Ofgem should be more prescriptive in its engagement, including being clear about where it believes stakeholder views are most valuable. This means there would be more confidence in applying consumers' views within the price control. Prescription of the business planning process would also assist in simplifying information that would be more comparable and lead to higher levels of consumer engagement. It would certainly cut down on costs in producing, reading, and responding to such data.

### **Imbalance in information and resource**

We believe that the imbalances between network companies and other stakeholders, including the regulator, require addressing. A more balanced stakeholder input will enable decisions that work in favour of all consumers, rather than those with the loudest voices (and the greatest financial resources). Other structural or procedural remedies (such as reform to appeal processes) should be considered.

## Value for money

Improved representation of stakeholder views is required around the allowed rate of return for investment. This is an example where the resource imbalance between the network companies and other parties is particularly marked, with network companies providing extensive consultant reports on highly technical issues. Active engagement of other stakeholders is required and a commitment to fully consider the results of that engagement.

Establishing the principles behind incentive design would allow longer-term incentives to be set and reduce the complexity of price control design. This should be done separately to the design of individual incentive schemes. Price controls are necessary because of the absence of competition and so incentive design should be seeking to replicate the incentives that would naturally exist in a competitive market. This means incentive schemes should be designed to reward those companies that are performing well *relative* to other network companies (and penalise those performing poorly) rather than against absolute targets set in advance.

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Published October 2022

Citizens Advice is an operating name of The National  
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Registered charity number 279057