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Office of Gas and Electricity Markets

By email only

May 19<sup>th</sup>, 2023

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## **Consultation on frameworks for future systems and network regulation**

Dear Colleague,

I am writing on behalf of ESP Electricity, a licensed Independent Distribution Network Operator ("IDNO") operating in Great Britain. We welcome the opportunity to respond to Ofgem's consultation on frameworks for future systems and network regulation.

We are supportive of the intent to review frameworks for regulation to bring about necessary change to the energy networks. While we recognise the benefits and costs of the three archetypes proposed in the consultation, we note that a key metric for success will be whether the chosen framework provides the necessary stability and transparency to ensure continued investability through appropriate compensation of risk. Should costs of capital increase materially, there may be adverse effects on financing which could lead to unwelcome impacts to consumers as the end users affected by the regulation frameworks.

Along side the proposed archetypes, we would welcome a framework that seeks to minimise the information asymmetries that exist between the regulator and network operators. This would lead to better analysis of strategic needs and reduce the costs associated with monitoring and auditing, ultimately to the benefit of customers who fund these costs through network charges.

We look forward to engaging with Ofgem as these proposals are further developed. We believe a framework that retains and encourages effective competition where possible will result in better outcomes for customers through competitive pricing, reduced costs, and improved service levels.

We have noted our responses to the consultation questions in Appendix 1.

If you wish to discuss any of the issues raised in our response or have any queries, please contact us at [Regulation@espug.com](mailto:Regulation@espug.com) or on 01372 587507. I can confirm that our response is non-confidential.

Yours sincerely,

Brandon Rodrigues  
Regulatory Analyst

## **Appendix 1: Responses to consultation questions**

Q.1. What should the role of the 'consumer voice' be and through what institutions and processes should it be channelled?

Q.2. How detailed could an independent, cross vector view become to determine future plans for periods beyond RIIO-2 and support effective use of the 'Plan and Deliver' model?

**Q.3. Under what circumstances would competition, or other procurement models such as open book contracting, have benefits over ex ante incentives as a cost control mechanism?**

The primary benefits of competition that we have identified from our market activity includes cost and service benefits to customers, competitive pricing, and commercial accountability, as we compete to be able to deliver the service. We think competition could be more advantageous than ex-ante regulation in a scenario where a central party dictates investment ahead of need as once that need is determined, competition could allow the industry to select a choice between various parties to provide a better and cost-efficient service for delivering that need.

Additionally, as we work with Independent Connection Providers to facilitate connections in the distribution sector, we note that risks associated with the build-out phase are reduced when inspection, monitoring, and adoption are carried out by other parties.

**Q.4. What is your view on the options identified for simplification of incentive regulation? What would be the benefits and costs by comparison to the approaches used in RIIO-2?**

There is a clear benefit in implementing changes to the existing structure compared to the introduction of entirely new pricing models. An incremental approach means that changes will be easier to understand and implement as they will primarily utilise existing processes and governance structures. We agree with the consultation that a negative aspect of archetype 2 is the opportunity cost of ex ante regulation which can result in underinvestment in terms of future need.

**Q.5. What are the network activities where there would be benefits for a move to an ex-post monitoring regime, and what would be the associated costs?**

We think there may be benefits for network activities that are primarily considered business-as-usual (BAU) to be governed under an ex-post monitoring regime. We do not think other activities would be appropriate (or even that archetype 3 is the most optimal approach for BAU activities) due to the potential issues around ex post regulatory intervention. While there may be a benefit if a lighter appraisal regime is used post project completion compared to the current up front in-depth assessments, ex-post regulatory intervention will require a high threshold for burden of proof and will also likely result in lower investor certainty due to potential intervention. These costs may outweigh the benefits in the short and medium term.

**Q.6. What are the benefits and costs of this approach for Electricity Transmission by comparison to an evolution of the approach in RIIO-2, and what are the implementation barriers?**

The electricity system will benefit from the Electricity transmission approach as investment will be mandated in advance and regionally optimised, leading to a more agile and flexible

electricity system that better meets the needs of the consumers. However, this comes with a cost in terms of resource and speed of implementation as it's relatively more complex than archetype 2.

An implementation barrier will be the need for the FSO (or other centralised planner) to be operational well before the start of the next price control in order to be able to set strategic outputs following the close of ED-2.

**Q.7. What is the potential for Electricity Distribution planning and commissioning to move to an alternative model by the end of RIIO-2, and what might be the benefits and costs of doing so?**

Two primary challenges are the timescales for implementation and operational ability. Moving to a different model would require Ofgem to establish the new framework and underpinning methodology within two years. Secondly, where Archetype 1 is utilised as a building block, it will require the FSO to be operational in advance of finalising the new framework.

However, a clear benefit of a new and bespoke framework is that it can target the strategic needs of the market as determined in the case for change. We believe that the optimal framework will utilise Archetype 1 for the strategic investments in advance of need while retaining other expenditures in Archetype 2. This mirrors the approach for Electricity Transmission and would ensure future needs are adequately considered while also ensuring simplicity and stability which will result in relatively stable or lower costs.

**Q.8. What is your view on the most effective approach to regulation of Gas Distribution and Transmission beyond RIIO-2? What would be the benefits and costs of moving to a simpler approach to regulation of the ongoing costs of operating and maintaining the network?**

We believe Archetype 1 is the most effective approach for regulation of gas beyond RIIO-2. There will be a need for strategic repurposing and efficient decommissioning of the gas networks in the medium to long term, and this may best be performed through the plan and deliver model. Archetype 2 can potentially be utilised as a building block framework for simpler regulation of ongoing operation and maintenance costs.

**Q.9. Should there be a shorter-term price control in gas distribution and/or gas transmission, and how could this work in practice?**

There will be a benefit of aligning price controls for Transmission and Distribution across both gas and electricity for a holistic view to regulation and future network planning. To facilitate this, we believe it is pragmatic to have a short-term price control to bring the price controls in line.

Q.10. Would there need to be any changes to maintain a stable and consistent financial framework if we were to make greater use of different regulatory archetypes, and if so, what would those changes need to be?

Q.11. Do you have any views on our proposed analytical approach?