

Consultation on frameworks for future systems and network regulation: enabling an energy system for the future

Annex 1: ENWL consultation response

10 May 2023



Contents

Introduction	2
Section 3. Archetypes for future network regulation	2
1) What should the role of the ‘consumer voice’ be and through what institutions and processes should it be channelled?	2
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?	3
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?	6
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?	7
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?	10
Section 4. Designing future network regulations	10
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?	10
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? ...	11
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?	12
9) Should there be a shorter-term price control in gas distribution and/or gas transmission, and how could this work in practice?	12
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?	13
Section 5. Analytical framework and next steps.....	15
11) Do you have any views on our proposed analytical approach?	15

Introduction

Our cover letter sets out our strategic feedback to this consultation, highlighting what we see as the most vital aspects for consumers and suggested policy directions that are in consumers interests. As such our cover letter offers a summarised viewpoint with this document containing detailed responses to the specified questions contained and published in the consultation document – ‘*Consultation on frameworks for future systems and network regulation: enabling an energy system for the future*’.

We note that appendices 2 through 6 of the consultation include example questions relating primarily to topics to guide/be discussed in the working group sessions on the five strategic topics identified. We will provide thoughts on these in the specific working group sessions and will seek to engage fully in discussions considering how the topics and items evolve through the ongoing group process. As such we have not covered them directly in this response.

Further, we note that this consultation also cites other inter-related consultations, by way of example namely – ‘*Consultation: Future of local energy institutions and governance*’ and ‘*Call for Input: The Future of Distributed Flexibility*’. We have considered the opportunities for consumers highlighted by all three parallel Ofgem processes in an integrated way. We request Ofgem consider our response to this consultation with that in mind, and in policy making, Ofgem sets out clearly how any inter-related policy decisions have been informed by all the consultations cited as well as the workshops as set out previous (where appropriate). This will ensure that the Ofgem policy making is as transparent as possible as well as coherent and joined up.

Section 3. Archetypes for future network regulation

1) What should the role of the ‘consumer voice’ be and through what institutions and processes should it be channelled?

We agree that the ‘consumer voice’ is a central element to a regulatory framework and, irrespective of the archetype deployed, has a role to play in ensuring the outcomes delivered reflect the requirements and preferences of the communities we serve.

Detailed understanding of the ‘consumer voice’ at local level will further ensure that place-based issues and legitimate differences in requirements and expectations are reflected in investment plans and delivery. Our engagement as part of our RII-ED2 business plan was the most extensive and effective engagement we have ever done, cementing our understanding of ‘consumer voice’ leveraging the special relationship we have with our consumers as well as our unique position as a single licensee area DNO. We are confident we are uniquely positioned to be able to have the most effective consumer relationships and therefore insights to shape business plans including investment requirements.

To ensure that the role of ‘consumer voice’ is optimally calibrated in the future of network regulation we offer the following observations and comments:

- The role of ‘consumer voice’ is pervasive in all types of network regulation, however, how the role is executed should be able to differ by sector, as well as by archetype(s) deployed.
- It is important that Ofgem/ relevant body, is clear and transparent up front as to the role and purpose that the ‘customer voice’ will take in informing/shaping the decisions and determinations that are made as part of identifying need/ price review processes. This should include what sort of evidence is expected and likely to be compelling to Ofgem.

- The ‘consumer voice’ should include stakeholders and representative bodies and not just consumers in their purest term. These groups are different in their configurations and requirements and ensuring that all actors requirements/ needs are reflected in forming business/investment plans are central to well-rounded outcomes reflecting regional and place-based requirements.
- We are clear in our expectation that as a regional DNO we will continue to be best placed to engage with our customers to render the requirements for the area we operate in through understanding the ‘consumer voice’. Going forward we see that the Regional System Planner (RSP) will also need to engage with local and regional actors, although the engagements are likely to be for different reasons and conversations. These should not replace our role in so much as:
 - We see the RSP understanding from a regional co-ordination perspective viewing multi-vector dynamics to allow better understanding of trade-offs for Net Zero delivery. This will likely include regional planning issues.
 - DNOs will understand customer and stakeholders wants, needs, plans and ambition from a place-based perspective where this information sits squarely with the DNO and its special and unique position in the regions we serve. Without this, important context around wants and needs for consumers will be missed and this is why a RSP will be unable to determine entire regional requirements completely divorced from the DNOs knowledge of place-based issues.
- We view that Ofgem itself has a role of understanding the macro ‘consumer voice’ at a national level, though this national view should be very carefully formed. We suggest Ofgem should more strongly embrace insights and messaging coming out of local and regional engagement to help form this national view and therefore we see the role of the DNOs and to some extent, the RSP(s) in helping with this mission.
- ‘*Workstream 4: Designing the process for price review: lessons learned from RIIO*’ is a great stream to draw out views on this question as well as lived experience of the ‘consumer voice’ in different sectors. From our experience the process for ED2 was not without cost for DNOs and it is important that Ofgem considers how it becomes more confident with the outcomes of this process of understanding and reflecting this in its determinations for the sectors it regulates. There is likely to be a sector differential in views on how effectively the ‘consumer voice’ can be drawn out and reflected in plans, borne out of the materially different experiences of stakeholders and consumers between the ED2 and other RIIO-2 processes.

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?

Our position is that the depth of independent views on future plans for periods beyond RIIO-2 is sector dependant. Additionally, the role of independent insight (either from the FSO or RSP) must be transparent, with the duties for all actors clearly defined especially at the boundaries of responsibilities between different parties.

The question couches the depth of the independent view in terms of the ‘Plan and Deliver’ archetype. We support that Ofgem needs a range of tools in its toolkit to deliver the best and most effective form of economic regulation. ‘Plan and Deliver’ is one of these tools that Ofgem should consider deploying though its application is likely to differ depending on the sector being considered.

For example, for Transmission (T) the use of 'Plan and Deliver' could be extended from its current form by reducing the threshold at which it applies to £25m where a project is new and separable. This would extend 'Plan and Deliver' by reducing the scale barrier to entry. We would support that this is also aligned for Distribution (D). This ensures that 'Plan and Deliver' could be applied to more work should that be in consumers interests but doesn't require it to be. We remain of the view that in putting any work forward as 'Plan and Deliver' there needs to have a strong consumer case where it is evident that the use of this archetype over archetype 2 can be quantified unobjectively. It is important that this process considers the use of these archetypes from a principles perspective.

Establishing a set of principles to guide which tool is used by Ofgem in which circumstances would support this process. Establishing guiding principles would support regulatory clarity and certainty, and it is our view that these principles should be applied consistently across sectors and activities, minimising boundaries and maximising whole system thinking.

Once these principles have been established, Ofgem should then apply these predictably and consistently to a range of new challenges. This would make it possible for consumer representatives, networks and investors to predict from Ofgem's principles how any new activity will be regulated – providing certainty that new activities will be regulated in a predictable and consistent manner. The principles could also extend beyond the regulation of the networks mentioned in this consultation to other parties for example iDNOs, hydrogen networks and even the FSO. This will facilitate bolder, more confident regulation in the face of uncertainty and inevitable changes that the sectors will face over the coming years.

It is also important that Ofgem is clear and transparent as to the definition of cross vector. Currently it is ambiguous as to the depth of what is and isn't in scope of cross vector consideration, for example is it expected to cover heat and/or transport. Cross vector could evolve over time and it is important that Ofgem sets out the baseline definition for now and any potential future roadmap including indicative timings for when and if this is expected to be broadened/expanded.

For Electricity Distribution (ED), our position is that independent view of future plans and needs should be calibrated at the regional level. We agree with the Ofgem proposal to create a Regional System Planner function and designate Regional System Planner (RSP) roles for Great Britain to ensure that sub-national whole system planning is developed and coordinated across multiple energy vectors; and for us it logically follows that the body accountable is a single regulated entity. The decision to create a Regional System Planner function is a critical development for a number of actors, and the detailed decisions that need to be made cannot be done by Ofgem alone without continued stakeholder input before the final shape and scope of the Regional System Planner roles are set.

We see that Local Area Energy Plans (LAEPs) play a fundamental role in developing and delivering a cost-effective transition to Net Zero for local communities. Our experience supporting the local authorities to develop an LAEP within the Greater Manchester region has shown us that there is a need for a coordination role to ensure the needs of local communities within a region are appropriately engaged and consulted. The Greater Manchester Combined Authority (GMCA) has recognised the need to provide guidance on the development of LAEPs so that the ten LAEPs (within the GMCA remit) can be brought together to provide a consistent and coordinated GMCA wide regional plan. This consistency of approach is vital and aids coordination for a regional energy plan as it mirrors the Net Zero targets that are set at a regional level. It is this framework that we envisage would work best for the development of a whole energy system plan for the new Regional System Planner roles. Figure 1 shows how the local actors contribute to the development of the LAEP, whilst figure 2 shows how this approach can be reflected for a Regional System Planner creating a regional whole system energy plan derived from LAEPs.

This approach ensures that the stakeholder voice is central to the development of an LAEP and remains place-based, whilst a Regional System Planner combines and coordinates the place-based plans bringing these together as a whole system energy plan.

Figure 1: how the local actors contribute to the development of the LAEP

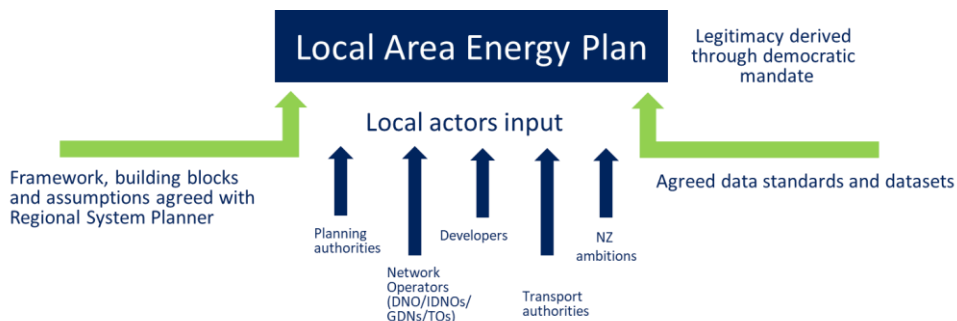
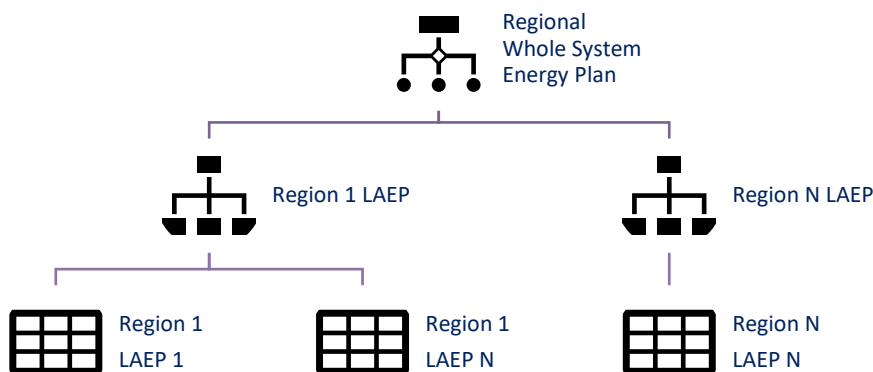


Figure 2: how the approach can be reflected for a Regional System Planner creating a regional whole system energy plan derived from LAEPs



As such, we consider that RSP(s) will need to work with local actors, with a democratic mandate, therefore we consider that the primary driver for RSP coverage would be the geographic boundaries of large regional bodies, such as nations, county councils and city regions, meaning a RSP is likely to cover more than one DNO operating area. This will allow sufficiently detailed information to be assessed and calibrated at the regional level delivering centralised holistic strategic planning at a regional level, linked to national planning providing a single source of truth for the regions plans. Place-based, and local planning issues at the DNO operating area should remain with the DNO to optimise, allowing it to leverage off its core competencies, and relationships with local stakeholders and consumers as a local, community business.

The distribution network investment plan is fundamentally dependent on the quality and timeliness of the inputs from RSPs and LAEPs. Agile uncertainty mechanisms (as designed for ED2) will continue to be needed to ensure there is sufficient flexibility (with appropriate controls) to adapt to alternative scenarios, otherwise there remains a risk that the framework is a barrier to Net Zero. This is similar to the current Transmission capacity issues, which have resulted in long connection queues and customer dissatisfaction. In establishing these new bodies, it is important that this risk is clearly allocated to the appropriate parties and appropriate uncertainty mechanisms are put into place.

Our view for Gas Distribution (GD) is that the depth of independent view is broadly similar to our position for ED largely for the same reasons even when noting the significant differences in current and future network characteristics. However, because this consultation is focused on the existing gas network, with hydrogen and heat policy out of scope, any views on new build requirements in GD could have more detailed policy views and input from the independent body, but at a broad level, for example in what circumstances should any expansion of the gas network happen in the next price control? Further where it is envisaged that the vast majority of the activity in this sector, as per Ofgem own analysis, is BAU/replacement activity it makes sense that this is left within scope of the existing operators without the need for detailed input from the independent body.

IDNOs (and their gas equivalents) are now very important and substantial providers of Net Zero enabling infrastructure. In our region much of the new build household connections are to an IDNO network and so these IDNO networks are vital to enabling Net Zero for a large proportion of households. Therefore, for independent networks and IDNOs, all requirements that apply to DNOs/GDNs should apply to them equally, specifically including the views on future plans from independent actors. It is crucial that these networks and distribution networks are Net Zero ready as is already expected of DNO operating areas with this being crucial to ensuring that no consumers are left behind on the journey to Net Zero.

With regards to Transmission (T) covering both Electricity (ET) and Gas (GT) it is our view that the depth of independent input would be of greater detail than that we have proposed for Electricity Distribution (ED) and Gas Distribution (GD). This is because these sectors have the broadest and wider ranging geographical impact and are of significant strategic choice/optimisation where trade-offs are likely to occur between large scale strategic investment options. As such the 'Plan and Deliver' archetype will likely lend itself more naturally here where projects are new, sufficiently high value and separable. We would suggest that with regards to the high value criteria this could be lowered to remove effective scale barrier to competition. Or view is that this could be set at £25m and applied consistently¹ to all sectors not just T.

Further, as the time to build projects in these sectors is long, the need to optimise and ensure decisions are made in an integrated way is greater for both GT and ET. We note that Ofgem has already established key building blocks with ASTI and CSNP which we support as these have filled a need to ensure no barriers/blockers remain where gaps have been identified. It is important Ofgem consider how these tools can be used to help inform the future regulatory framework in these sectors as well as the price control for T3. One consideration of this is how competition through 'Plan and Deliver' model is supported by ASTI/CSNP where key activities and investment which have already been established and commissioned through those same processes in the medium term. Ofgem could be looking at needs for 2040 and beyond as to what is right for 'Plan and Deliver' with CSNP looking further out than 2035, though this should be considered more broadly in aims and outcomes sought by Ofgem.

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?

As per our response to question 2 we support that Ofgem needs a range of tools in its toolkit to deliver the best and most effective form of economic regulation. We would further note that competition is already inherent within all three archetypes, for example through native competition within the RIIO incentive based regulatory model as deployed currently within ED. Within ED, competition and

¹ along with the other criteria of new and separable

tendering is used to deliver services and activities on behalf of the DNO where these are best value delivered by a third party. DNOs have actively used this throughout ED1, and we see no reason why this wouldn't continue in ED2.

It is our view that broadened competition could have advantages for large projects as envisaged already within RIIO. Under the 'Plan and Deliver' archetype a broadened competition model is best facilitated where projects are new, sufficiently high value and separable. We note that this is ostensibly the same criteria as currently deployed by Ofgem though we would extend by lowering the high value threshold to £25m for all sectors including ED.

We think this best serves all consumers interests though it is also important that deliverability is brought in as an important consideration given the criticality of optimised investment required to deliver Net Zero across sectors and vectors. Ultimately strategic investment on critical assets and infrastructure means that DNOs, Ofgem or the independent body must ensure that third party providers identified through competition are competent to ensure no consumer detriment occurs.

It is also important that Ofgem or the independent party carefully consider the consumer benefit for applying competition where the consumer case changes over time through changes in operating and market conditions. For example, should the cost of capital allowance determined by Ofgem in the price review process remain as low as currently established, this makes the appetite for competitive delivery lower/harder to incentivise against the counterfactual of monopoly delivery when considering finance cost specifically.

Competition on a project by project basis isn't always totally effective as a cost control mechanism for the overall costs to consumers for achieving a specific output. For example, Ofgem needs to be wary of low bids that then sees escalated costs driven by variations. Competitive schemes, whether programmes or single projects, be they large or small, can often see these project cost variations, changes in delivery timescales and inherently can end up in contractual disputes (incurring significant legal costs). These all represent negative effects on cost controls as opposed to RIIO where costs are managed as a collective with efficiency of delivery incentivised rather than bidding low before construction activity is actively undertaken.

Delays and the lowering of the standard of assets must seek to be avoided given the objective of Net Zero, the pace needed and the invest to connect mantra being pursued. Compatibility with Net Zero is key. Retrospective retrofitting of assets where short-term delivery isn't meeting longer term requirements needs to be avoided which can be a consequence if a competition model is used as a cost control mechanism and requirements are incorrectly specified and immediate cost control is overly prioritised.

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?

It is our view and experience that incentive-based regulation as at the core of the RIIO model is the most superior and beneficial form of regulation for consumers. In the ED sector, we are clear it has delivered broad benefits for all consumers and we expect it will deliver progress towards Net Zero at least cost during ED2.

Ofgem needs a range of tools in its toolkit to deliver the best and most effective form of economic regulation though, as in RIIO, a strong core of incentive-based regulation is crucial to delivering optimal outcomes for consumers and the wider sector. We consider that the evolution of RIIO-1 to

RIIO-2 has increased the tools available to Ofgem, and that the RIIO model is sufficiently flexible to incorporate further evolution without the need for fundamental revolution. Care must be taken to ensure the core of incentive and innovation driven benefits to consumers is not lost.

Incentive-based regulation works best when outcomes and incentives are aligned for all stakeholders including both consumers and investors. This inevitably brings in an aspect of complexity, both real and perceived, but this is ok as long as the outcomes sought/ delivered justifies the complexity that is built into the process. Aspiration of simplification of the process should not be the aim on its own without due consideration of the impact on consumer outcomes or risks to the same.

Price controls are onerous and complex, and in many cases, with very good reasons. Each price control seeks to have simplicity as a guiding principle, but rarely manages to deliver on this. A price control is necessarily complex, but the process to reach a final determination can and should be simplified where this can be done without detriment or risk to consumer outcomes.

It is in this context which we support the principle that simplification and transparency should remain objectives but set within the context of price controls avoiding unnecessary complexity. Price controls aren't simple nor easy to understand by their nature especially where they include mechanisms designed for consumer outcomes whilst dealing with uncertainty around input from externalities. Price controls need to be accessible to stakeholders to understand and the justification of complexity should form part of this wider understanding. It is our view that a focus of simplification could be to reduce the labour-intensive nature of the price controls for Ofgem and companies with streamlining of assessment processes before and within price controls as an aim.

With even greater uncertainty expected in the future, the need to develop a much-streamlined process is needed when unlocking the required uncertain expenditure if ED is to respond to changing needs in the pace required. Wherever possible, automated mechanisms such as volume drivers that release funding when the need arises rather than complex application processes should be identified and deployed. Ofgem should additionally explore how to reduce the regulatory burden on complex application processes including, for example, what a light touch re-opener might look like.

Each price control setting process brings its own challenges, and with-it lessons learnt. We welcome the workstream looking at this, and it is important that future price controls react to the lessons learnt from the past (not just RIIO-2) and strive for continuous improvement.

Further to this and specifically with regards to RIIO-ED2, evolution of the RIIO model to meet the needs of the day, and with future need consideration in mind, has seen significant changes to the form of incentive-based regulation which have only just gone live. The benefits of this evolved and adaptive model are yet to be observable and Ofgem needs to carefully consider the timing of any decisions where future observable benefits are yet to have been realised and considered in decision making for future price control periods.

We view reversion to an RPI-X model as being a retrograde step in this context. It is the expansion of need in ED to facilitate Net Zero without constraint or delay that means RPI-X isn't appropriate for the sector. An RPI-X approach risks undoing the core benefits of the evolved RIIO model which encourages innovation and incentivises investors to value outcomes which are aligned with consumers interests. Reversal to RPI-X would stifle much needed innovation risking Net Zero and wider consumer outcomes/ benefits.

Therefore segmentation of the price control would increase complexity with little or no benefit to consumers. It is not clear that transparent and observable segmentation of the price control can actually be meaningfully undertaken. One benefit of the RIIO model is that networks seek to optimise

costs within a Totex framework across all cost and activity types through efficiencies and use of innovative techniques and operating models. This includes BAU costs and activities which, if segmented and treated differently, would not only risk worsening of future outcomes in these areas but also limit the scope of future innovation streams where there are cost trade-offs which occur across and between different cost categories.

RPI-X could be applicable to sectors where little or no future growth in requirements or investment is required but this is not a characteristic of ED where growth is universally expected, and it would need to be carefully justified to ensure that this isn't value destructive for customers even in sectors that may have this characteristic.

With regards to the specific options identified in the consultation document; option 1 (set out in 3.24), is in our view not an optimal/ good option for regulation in the context of application to ED. As previously indicated, costs are not easily or readily separable in ED into "business-as-usual" activities". To attempt to do this would risk stifling wider innovation where cost trade-offs exist as well as where these impact on what may be considered as BAU type activities.

As for Option 2 (set out in paragraph 3.25), again responding in the context of ED, ex-post assessment methods are negative in terms of underpinning investor confidence which in turn will risk outcomes for customers and potential costs where additional ex-post risk through regulatory uncertainty is created. We set out our positions on the need for managing expectations and change and how this will impact on the risk and return element of regulatory framework in our response to question 10 of this consultation.

Productivity assessment is challenging to undertake especially when focused on a single sector and actual outturn performance. Moving to agreeing a methodology upfront with ex-post assessment is characterised as a simplification but in reality will increase the complexity of a price control process in both determination and close out. Significant time would need to be spent determining and consulting on the upfront framework which would need to be fairly calibrated and reflective of the inherent characteristics of companies and DNO groups including scale and scope considerations.

Upfront calibration of the ongoing efficiency challenge (through productivity assessment of appropriate representative sectors within the wider economy) whilst not perfect, is preferable as it is transparent, using established and recognised techniques which set stretching targets on companies to achieve across all Totex investment. This also sets clear and transparent requirements on companies ahead of the price control, underpinning regulatory good practice of creating certainty and allowing the freedom to deliver in the best way considering links to the 'consumer voice' and outcomes required.

Also, in the context of ED, the number of comparators and observable data points and the form of regulation goes hand in hand. It is clear that for those sectors such as ED where the number and depth of information is at such a level, appropriate sector benchmarks and calibration can be achieved and undertaken through comparative regulatory techniques such as cost assessment modelling.

This is evidenced through the outcomes for GD1 and ED1 where it is observable and arguable that due to the increased information for ED the outcomes seen for ED1 represent a well calibrated and challenging price control where companies setting the benchmark on cost and performance are rewarded through incentives earned/realised. This seems less the case in GD1 as we observed it where the number and depth of observations are much fewer making ex-ante calibration much more challenging. This underpins our position that incentive-based regulation is the best option for ED regulation.

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?

It is our view that the 'Freedom and Accountability' archetype has little benefits over the other options and is unlikely to be relevant for wide application. In general, this archetype is more risky and costly for consumers and investors as well as stifling innovation. Therefore, its application needs to be carefully considered and justified beyond the basis of simplification of the price control framework.

There are examples within the current RIIO model which are types of mechanisms on the spectrum associated with a 'Freedom and Accountability' archetype. For example, in ED2 the use-it-or-lose-it mechanisms (UIOLI) for Worst Served Customers (WSC) and Undergrounding for Visual Amenity (UVA). The UIOLI sets an upfront allowance which is agreed as part of the price control determination. It is for companies to determine how best to optimise the allowance which is tethered to a certain area and criteria of activity. Any allowances not needed by companies are returned to consumers. It is the clear and transparent definition of qualifying schemes/investment which is crucial here as this guides the companies in where to invest to meet the need identified ensuring that investment is ring-fenced for the activity in question.

As in our response to question 4 we view that, in the context of ED, separable activities and costs are not easily or readily identifiable. It is inherent within ED that there are trade-offs across cost types and categories which are optimised at present due to wider delivery considerations and the impact of innovation and innovative models deployed. This is therefore best accounted for in the single till model (Totex) allowing this optimisation across activity and cost types. This totex approach sits in the context of a robust ex-ante efficiency assessment through comparative benchmarking processes underpinned by sufficient comparators and data points. This by definition would not occur under a 'Freedom and Accountability' archetype.

Therefore, we do not see how 'Freedom and Accountability' in its purest form is applicable to ED beyond relatively very small scale, niche and targeted aspects of this archetype as exemplified by UIOLI mechanisms deployed in ED2. ED is a growth sector where investment and outcomes need to be aligned with customers/consumer wants and needs and is best delivered through a core of incentive-based regulation.

Section 4. Designing future network regulations

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?

As set out in our response to question 1 the 'consumer voice' is a central element to a regulatory framework and, irrespective of the archetype deployed, has a role to play in ensuring the outcomes delivered reflect the requirements and preferences of the communities we serve. Additionally, we support that Ofgem needs a range of tools in its toolkit to deliver the best and most effective form of economic regulation. Therefore, in principle we are in broad agreement with the example design set out in figure 5 of the consultation.

We would note that investment requirements identified in ASTI currently is by definition exempted from 'Plan and Design' (archetype 1) for RIIO-T3. There is a risk here that should the impact assessment identify that additional benefits can be secured through the deployment of 'Plan and Deliver' model for T3 that this is forgone for a large part of investment needs for that period. Ofgem should consider

this carefully as well as ensuring this is correctly reflected in its impact assessment (see question 11 for a more detailed response).

One key “implementation barrier” is ‘reflective and robust assessment of the impact of change’ considering company financeability, risk and return as well as the ability of the sector in question to attract the sizeable investment requirements to meet consumer needs and delivery of Net Zero targets. Careful consideration of financing for the existing companies, accounting for their individual circumstances is crucial. It is not in consumers interests to erode financial stability, risking unnecessary cost increases as well as the outcomes sought by consumers and as defined by the Government in terms of Net Zero.

With uncertainty about precisely how Net Zero will be delivered it is important that the outcome of this consultation does not pre-empt the route via which this will be achieved, and instead that future regulatory frameworks are developed in a way that can be agile and flexible to changes in pathway.

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?

With regards to ED it is very difficult to tell whether early proposals from Ofgem in the consultation have merit. The benefits of the evolved incentive-based model for ED2 are yet to be observed and we question the value of whether early proposals, without observation of the counterfactual, can be meaningful at this stage.

It is ambitious of Ofgem to push for change and new regulatory frameworks across all sectors in one go, including the use of ‘Plan and Deliver’, with the increased ongoing oversight needs that this would place on Ofgem across all time periods. We view that the case for change is more tangible in T and with this price control earlier than ED3 it would seem sensible to focus on this sector first. This would allow time for benefits of the significant changes Ofgem has deployed for ED2 to be realised providing much needed data to input into assessment of the case for change for ED.

With the uncertainty about precisely how Net Zero will be delivered it is important that the outcome of this consultation does not pre-empt the route via which this will be achieved, and instead that future regulatory frameworks are developed in a way that can be agile and flexible to changes in pathway. Some of this agility has been built into the framework for ED2 and Ofgem needs to consider in due course how this is operating and whether this provides a useful blueprint for ED3.

Ofgem should be comforted by the active engagement from DNOs with relation to the consultations on local institutions and governance reform and we re-iterate here our support for the proposals on development of RSP(s), central market facilitation and flexibility system exchange and we look forward to the continued engagement as the detailed design options are considered.

For ED we see the RSP function setting the framework and the elected bodies, with democratic mandate for the local area, leading the local area energy plan process convening local actors to reflect the policies for Net Zero and the aspirations of the communities they serve. Further, we see place-based planning residing with local actors with the core competencies to deliver effective energy plans under a democratic mandate with the RSP undertaking regional coordination and ensuring differing local ambitions are reflected in the regional whole energy system plan.

We do foresee that where there is major single investment, even at the DNO level, where these meet the criteria we have previously set out in this consultation (new, high value >£25m and separable) these should be considered as subject to the other archetypes, namely 'Plan and Deliver'.

8) What is your view on the most effective approach to regulation of Gas Distribution and Transmission beyond RII0-2? 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?

As set out in our response to question 1 the 'consumer voice' is a central element to a regulatory framework and irrespective of the archetype deployed, including 'Freedom and Accountability'. The role we play is to ensure the outcomes delivered reflect the requirements and preferences of the communities we serve as well as their expectations. 'Freedom and Accountability' is one of the tools that Ofgem needs in its toolkit to deliver the best and most effective form of economic regulation. Although our view is that out of the three archetypes presented, this is less likely to be applicable and, therefore, used least.

In principle where the regulatory framework/ archetype deployed is fit for purpose for 90 percent of the sector activity we are unclear what additional significant benefit can be achieved through differential treatment of the remaining 10 percent. This is particularly the case when the costs and implementation challenges are considered. It is important in this context that Ofgem needs to avoid creating a situation where uncertainty about a sub-set of networks' activities undermines regulatory certainty about the regulatory framework that will apply to all activities, including those business-as-usual activities that networks will continue to need to deliver. Therefore, we urge Ofgem to carefully consider this as should 'Freedom and Accountability' be used inappropriately this could worsen outcomes for consumers whilst simultaneously increasing cost.

Whilst relatively obvious, it is important to note that future treatment and uncertainty around heat policy will have a major impact on this sector. Ofgem needs to be cognisant not to exacerbate the uncertainty. We note that hydrogen is out of scope, but this will clearly have tangential and knock-on impacts specifically on GD and GT. This example of uncertainty about precisely how Net Zero will be delivered is an important one for Ofgem to consider. Future regulatory frameworks need to be developed in a way that can adapt and be agile to changes as uncertainties are realised.

We note that Figure 6 also includes a row for "New build" in the context of GD/GT. Whilst it is unclear where this fits in considering the traditional gas networks, we agree that where this is identified and justified it could be delivered through a 'Plan and Deliver' archetype.

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

As a foundation for the future of network regulation it is vitally important that the specific attributes, needs and challenges of the Electricity Distribution sector are considered on their own merits and not unduly bound by decisions made for other sectors with a fundamentally different makeup. We strongly support Ofgem's own stance that decisions on the form of the ED3 price control should be made at a more appropriate point. Therefore it is in this context and with regards to this question that we note the characteristics of Gas and Electricity are diverging more than ever. There is a risk that aligning Gas and Electricity controls within the same regulatory period confounds rather than enables effective, sector-specific regulation. We see little or no benefit to aligning the price controls given this inherent difference in characteristics and pathways.

We do not support shorter price controls for network companies in principle as any period less than five years is too short to deliver benefits that outweigh the increased cost for consumers. If Ofgem is contemplating extending the current five-year controls by two years this could potentially retain some of the consumer benefits from the incentive based ex-ante regulatory approach already in place, but any extension needs to be very carefully managed.

Further, the reasons for extending the price control period need to be very clearly set out along with analysis of the costs and benefits for consumers. We do not think that to properly extend a price control by two years this can be done without significant time, effort and engagement on the part of companies, stakeholders and Ofgem nor will it be a simple exercise for all parties. It may also be a factor for Ofgem to consider whether there are efficiencies of undertaking GT and GD price controls together when looking at common issues related to the Gas sector.

Overall, we think there is a risk of disproportionate effort being required to align distribution controls when compared to the potential benefit. In the medium-term, extending a price control will be more impactful on all stakeholders (including Ofgem) given the extra work created compared to completing a full process. The benefits of extending the current GD2 price control need to be certain, because substantial additional costs under an extension scenario are clear.

We suggest Ofgem publishes, as part of this consultation process, the detailed analysis of how RIIO-GD2 is performing for customers. Whilst still relatively early in the GD2 price control, GDNs (like DNOs) provide Ofgem with Annual Regulatory Reporting in July each year. Publishing the GDN sector performance report and any other information on how GD2 is progressing needs to be expedited. Further we expect Ofgem itself would want to receive all the detailed GDN reporting information it receives each July as part of making any decision on extending GD2.

In summary, we have not yet seen sufficient clarity or certainty of the benefits that might come from extending GD2 and starting GD3 in parallel with ED3 to justify a change.

Should a decision be taken for Gas sector price controls to be aligned with ED, it is vital that Ofgem assesses the practical requirements including the resourcing impacts it would be placing on itself clearly noting and understanding the very different characteristics of the ED and Gas sectors. ED needs to rapidly grow to meet the Net Zero challenge, whilst the future for GD is less clear. Further the types of costs and activities are very different across the sectors and the investor appetite is also likely to vary between these sectors. These differences clearly and unobjectively merit their own careful and thorough consideration.

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?

Ex ante-based incentive regulation has delivered for customers and investors since its inception and it has become a role-model around the world for a stable and consistent regulatory regime.

Customers have benefited from real (inflation-stripped) bill reductions, alongside world-class network innovation, service improvements and reliability; while debt and equity providers have benefited from a predictable and stable regime thereby allowing increasing investment of long-term “patient” capital.

Any move away from this successful regulatory model can only be justified if the changes would provide clear and demonstrable benefits to customers over the longer term. We do not believe the greater use of different regulatory archetypes would provide an overall benefit to customers in ED.

Indeed, it is our view that introducing such changes would disrupt the financial framework and, very likely push up capital costs for consumers over the long-term.

We believe that further detail and evidence is required, including robust impact assessments and a detailed review of the risk/reward trade-off on each archetype individually, and in combination.

From a financial framework perspective, we see the following key challenges from the use of different regulatory archetypes:

- **Financeability:** Capital is provided at network level. As such, financeability, (the ability of networks to successfully attract and retain capital) can only be assessed at network level. It cannot be assessed fully at archetype level, nor can the regulator's financeability duty be discharged at the archetype level.
- **Only way is up:** The ED2 price control was calibrated so that the notional company could just about achieve an interest cover ratio of 1.40x its interest costs. This is the minimum interest cover ratio to deliver a Baa1 (BBB+) rating. At a notional network level, the introduction of alternate archetypes could not deliver a lower cost of capital without a de-rating of the sector, as cost of capital has already been set on a notional basis that is only just sufficient.
- **Investor access:** Capital is provided at network level, where the risks and rewards are consolidated. As such, the use of different archetypes would be extremely unlikely to provide any access benefit to networks when sourcing capital – without ring-fencing, there would be no reduction in barriers to entry or ability to target investor exposure with networks.
- **Capital allocation:** Different risks and returns across archetypes would very likely impact network behaviour and investment priorities. This may not be in customer interests.
- **Risk:** The low cost of capital in RIIO-2 is supported by the high degree of visibility and confidence in cash flows associated with Archetype 2. The introduction of additional archetypes in some capacity could increase uncertainty and variability in network-level cash flows, thereby increasing investor risk and requiring higher returns over the long-term.
- **Market data:** Equity returns are calibrated using market data. Any material changes to the regulatory archetype would be fundamental and it would take time for changes to be reflected in market data, thereby increasing the risk that returns would be set at the incorrect level. Additional fail-safes would be needed to ensure that returns were sufficient during price controls.
- **Notional company:** The introduction of different archetypes will create uncertainty in the financial framework. The construct of any notional company would require a baseline view on spend and returns generated in each archetype. The regulator must avoid a scenario in which a network is unfinanceable because it does not achieve the business mix assumed for the notional company. This dynamic would likely lead to returns being set higher than required level under a single-archetype model, due to the need to protect against this uncertainty.
- **Regulatory risk:** The changes considered in this consultation are fundamental. Taken together with the potential consultation on the treatment of inflation, there is significant uncertainty created around investment for the Energy sector. While it is appropriate to consider changes to the price control framework, Ofgem needs to remain measured and introduce changes only when fully justified and well signalled. To do otherwise would risk undermining confidence in GB regulation which could lead to ratings downgrades for utilities and ultimately higher bills for customers.
- **Complexity of implementation:** Because any changes in this area are key for consumers we suggest extensive and robust implementation detail is required before any decision to change is made. This would need to be comprehensively and carefully briefed out as well as understood by a range of stakeholders, with their input sought and considered. What we understand is conceptually envisaged by the consultation would require more detailed review

of any necessary changes before it would be possible to move to assessing choices and planning implementation.

We recommend Ofgem continue with a framework based predominately around Archetype 2, although we do believe it is necessary for a 're-think' to setting the debt allowance methodology. As evidenced by the need for a calibration adjustment in RIIO-ED2, a flat indexation profile is not adequately responsive to changes in market conditions. This has been demonstrated as leading to a significant risk of over or under funding of the sector.

A policy that ensures debt costs are adequately and appropriately funded is critical to raising the capital needed to deliver Net Zero. The current one-size-fits-all approach is not necessarily the best approach, and the problems associated with such a policy would be accentuated by the introduction of additional archetypes and greater investor uncertainty in the sector. The less homogeneous the sector is (or may be), the greater the need for an individual company, or sub-sector, approach to financing.

We have proposed alternate methodologies that we feel would be more appropriate, including time-weighted indexation and a debt sharing mechanism. We would welcome an opportunity to discuss these in more detail with Ofgem.

As a final suggestion, we note that this consultation omits a fundamental building block of the current regulatory framework, namely inflation. Future stability and consistency of the framework is also critically dependent on the outcome of the separate inflation review Ofgem has signalled it is contemplating. This could have far-reaching and damaging implications for regulatory stability. Therefore, these two reviews should not be considered separately as they are inextricably linked and could lead to severe compounded impacts on risk, driving up energy sector financing costs ultimately faced by all consumers.

Section 5. Analytical framework and next steps

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

We would welcome greater detail on the problems Ofgem is seeking to address through this consultation at a sector level. We understand the macro drivers as presented in the consultation, but these need to be set out in more detail where potential solutions/archetypes are reviewed against those problems identified and documented on a sector by sector basis. This will also help to determine how best to resolve the problems identified. A more bottom up approach for each sector would therefore be a preferable way to look for costs and benefits of change. These should be considered against the appropriate counterfactual and in the context of the outcome sought or a problem identified.

We note the analytical approach and framework set out in section 5 of the consultation document. Whilst we welcome the inclusion of this and the input Ofgem are seeking from respondents, our initial views are that what is presented is relatively high-level and it is difficult to comment on specifics given the lack of these in the consultation document. We do recognise that given the stage of framework development, specifically noting the timeline and stage for ED, that this is to be expected.

Given the high-level nature of the content presented we would offer the following high-level observations:

- **Inter-generational impacts;** Any future price control framework will likely need to move away from a short-term focus on immediate bill impacts and should seek to unlock strategic investments across the whole of the energy system ensuring that networks play the transformational role needed. Therefore, delivering longer term benefits to the bill payer and economic growth, in a way that is equitable and ensures inter-generational fairness, needs to be considered in the impact assessment undertaken by Ofgem.
- **Future costs should not be undervalued;** It is important any potential costs, including long term costs, are not undervalued. Ofgem should exercise caution in the assessment of costs and not be overly optimistic in its assessment of these given the impact on companies and consumers of undervaluing costs where they underpin a case for change.
- **Future benefits should be fairly valued;** As with costs, fair valuation of the benefits is needed given these are likely to be intangible and become less certain as they are assessed over longer time periods.
- **Future costs and benefits need to include financing impacts;** It is not only important but vital that Ofgem incorporates realistic assessment of the impact on financing costs incurred by companies, covering both equity and debt. This is crucial in the context of Net Zero and the sizeable investment likely to be required, including the ability of sectors to attract the inward investment needed.
- **RIIO-ED2 benefits and costs will not be observable immediately;** The benefits of the evolved framework for ED2 are not available yet. The framework went live on the 1 April 2023 and Ofgem should seek to wait and understand the impact the evolutionary changes which have been deployed for ED2 have had on the outcomes sought. This is of increasing relevance where the decisions and start of ED3 are less pressing as those for RIIO-3 (GD and T).
- **Failure to meet regional as well as national Net Zero targets should not be undervalued or discounted;** Devolved regional authorities have set out targets to meet Net Zero in many cases more ambitious than those established by the Government. The costs of failing to meet these, as well as national targets, needs to be considered in the analytical approach.
- **Where there is a fundamental change in the incentives placed on network companies' indirect benefits and costs become more important than direct costs;** We agree with the consultation document that costs/benefits of incentive changes on companies need to be included. We would assert that these are fundamental to the assessment undertaken. Network companies respond to incentives that deliver outcomes and activities which are aligned to the very same incentives. Without this, or without aligning outcomes sought with incentive dynamics, what is delivered will likely be mismatched. This is essentially the core benefit of incentive-based regulation that, where done well, the interests of customers, consumers, stakeholders, companies and investor are aligned.
- **Costs and benefits should not assume continuation of the form of regulation in perpetuity;** Unless Ofgem is seeking to develop a framework which is enduring over the longer term (which is not the stated aim of FSNR), careful consideration of the time period to which the costs and benefits are assessed is needed. Ofgem has generally evolved the form and method of price control at regular and frequent intervals, aligning with the end of previous price control period. These changes are not unsubstantial and as such benefits and cost cannot be claimed in perpetuity, as the form and type of price control framework is unlikely to be enduring where future needs change and flex.

- **Quantification is always preferable to qualitative assessment, though the numbers and values used need to be meaningful and robust;** In assessing and making the needs case for significant and major change it is preferable to use quantitative analysis. However, where the data used to underpin quantitative analysis isn't sufficiently robust or reliable, qualitative analysis could actually be preferable. Ofgem in its analysis should consider sensitivity assessment. Assessment of the sensitivity of the needs case for change, including variations in input values assumed, is important in broad decision-making processes where the costs and benefits utilised can be intangible.
- **The impact assessment should not seek to be perfect and delay any changes needed to deliver Net Zero;** Whilst it is important that the justification of policy/framework decisions are robust and not rushed we propose that this must not become a blocker to changes that need to be made. Where the case is more obvious, Ofgem should not delay implementation by being too precise in terms of the impact assessment undertaken. Where the case is less obvious or positions more nuanced and finely balanced, time should be taken to carefully assess these to ensure correct decisions are reached.