



Northern Powergrid response to the Ofgem Consultation: Future Systems and Network Regulation

KEY POINTS

- The RIIO Framework has driven good outcomes for customers since its inception. Its flexibility and focus on incentives, innovation and outputs remains right for the future. In the case of electricity distribution these include lower costs, shorter power cuts, faster connections, and better customer service.
- It is important to recognise these regulatory successes and build on them, allowing customers to continue to benefit from the positive effects created using RIIO principles.
- A regime with strong incentives that encourages efficient investment in system resilience and optimisation, innovation and customer service will be key to meet the challenges of the net zero transition, energy independence and the cost of living for consumers.
- As ever, there is scope for incremental improvement of the existing framework, but nothing in the diagnosis points to the need to completely depart from the RIIO model. Rather it points to measured and reasoned adaptation.
- The archetypes set out by Ofgem may each be suitable for application under different circumstances, however:
 - Archetypes 1 and 3 have some serious drawbacks that have the potential to create inefficiency and/or undermine investor confidence if not used with great care. Therefore, they should only be used in a relatively narrow set of circumstances.
 - Archetype 2 – ex ante regulation – should be used as broadly as possible, typically where output targets and cost allowances can be set with a relatively high degree of confidence.
- The RIIO-2 framework has become complex, largely driven by uncertainty in the external environment. The FSO is the key to simplifying the price control framework.
- A properly scoped FSO, with clear obligations for setting a common scenario, will bring planning confidence and consistency to the forecast period ahead and coherence across the nation's investment plan.
- This planning framework should be set at a national level with a centrally managed and regional facing agency to deliver the consistency required. Regional networks – in our case DNOs - should retain the accountability to efficiently plan and operate the networks – in line with their obligations.
- Ofgem can then have confidence to simplify the price control, utilizing ex ante allowances as broadly as possible and supplementing this with in-period uncertainty mechanisms or Archetype 3, for targeted issues.
- That framework allows Ofgem to significantly reduce the regulatory burden of the current framework while encouraging the required investment and innovation that will enable decarbonisation at the lowest cost to customers.

1. Executive Summary

The RIIO Framework has driven good outcomes since its inception. Its flexibility and focus on incentives, innovation and outputs remain right for the future.

1. Customers have benefitted from the sound foundations of incentive-based regulation. Within electricity distribution these include lower costs, shorter power cuts, faster connections, and better customer service.
2. It is important to recognise these regulatory successes and build on them. This will be key to meet the challenges of the net zero transition, energy independence and the cost of living for consumers.
3. Strong incentives, including for investment, cost efficiency and consumer outcomes, will be essential to deliver the significant benefits to consumers from the lowest-cost pathway to meeting net zero targets. To that end, given the success of incentive-based regulation in delivering good outcomes for customers, Ofgem must utilise it as much as possible and consider adapting that framework to include a sensible and proportionate approach to uncertainty.
4. There is scope for incremental improvement of the existing framework, but nothing in the diagnosis points to the need to completely depart from the RIIO model. Rather it points to measured and reasoned adaptation.

The current RIIO-2 framework would benefit from simplification in the next review, to lessen regulatory burden and encourage investment.

5. In recent price control reviews Ofgem's response to uncertainty in its various forms has increasingly been to introduce in-period reopeners or uncertainty mechanisms. There is an administrative overhead associated with each of these, which ultimately results in a lack of agility. Furthermore, some increase the regulatory risk faced by DNOs due to the potential for unremunerated investment.
6. As a result, Ofgem's current framework risks undermining investor confidence and, in the case of the upcoming RIIO-ED2 period, might fail to create meaningful drivers for innovation and efficiency and the associated improvements that would result for consumers.
7. Simplification of the price control framework is necessary for Ofgem, networks and stakeholders.

The optimal blend of Ofgem's archetypes will likely differ from sector to sector. The RIIO framework has been extremely effective and successful in the electricity distribution sector and its principles should be maintained.

8. Ofgem requires a range of tools in its regulatory toolkit – this has always been true. Each of the archetypes represents extremes on the regulatory spectrum, none of which alone are likely to lead to a good outcome if applied in all situations. However, each to some degree could have a role to play specific to each sector context, guided by clear principles.
9. Out of the archetypes set out in the consultation, simplified ex ante based regulation is the right path for electricity distribution to encourage effective competition, innovation and investment at a time when networks need to invest. The scope for ex post review should be limited to targeted uncertainty mechanisms, alongside a well scoped FSO setting a common scenario to

bring the consistency in investment plans needed to give Ofgem the confidence to reduce its reliance on true-up mechanisms.

A properly scoped FSO is the key to simplification of the price control.

10. We broadly agree with Ofgem's characterisation of the strategic issues facing the sector and recognise the challenges they create for future regulation, not least because the outlook is likely to be very different in each sector. For instance, the need to rise to the challenge of load growth and the new generation of electricity networks differs greatly to the uncertainty surrounding the future of gas and the extent to which the gas networks need repurposing to transport hydrogen.
11. Although the transition to net zero brings much greater uncertainty than the industry has faced previously, it is certain that all the decarbonisation pathways require increased investment in the electricity distribution networks. So, it is more important than it has even been that Ofgem preserves the incentives on network companies to minimise total costs and to reveal information for future price controls.
12. The complexity of RIIO-2 was largely driven by uncertainty in the external environment and inconsistency across regional planning frameworks. The appointment of a properly scoped FSO, which could credibly hold the Regional System Planner responsibility and therefore specific obligations around setting a common decarbonisation scenario across all energy vectors, should give Ofgem confidence for the forecast period ahead while enabling consistency and coherence in the nation's investment plan.
13. This would allow Ofgem to confidently set ex ante allowances and use uncertainty mechanisms only where needed for targeted issues, thus simplifying the price control, encouraging innovation and efficiency, ensuring the speed of investment, and shoring up investor confidence.

DNOs should retain the accountability to efficiently plan and operate the electricity network - it is their obligation to own, operate and optimise the local networks.

14. This planning framework should be set at a national level with a centrally managed, regional facing agency charged with delivering the consistency Ofgem seeks. The Regional System Planners (RSPs) should be responsible for the planning framework and setting clear scenarios across the energy system. DNOs can then take this information, challenging it as appropriate, and use it to efficiently plan, develop and operate the electricity network.
15. Ofgem must ensure that it does not blur or dilute accountabilities and obligations that rightly and properly sit with the entity who runs the network. In other words, whatever changes are made to the wider planning framework at the system level, DNOs must retain the both the funding and responsibilities associated with building and running the network to meet the requirements of customers and the law. It is the DNO that has the obligation to own, operate and optimise the networks at the local level and it is the DNO that has the expertise for optimising at that scale. In any case, the FSO would lack the capability and capacity to do so – but more important is to make sure that the accountability for the effective planning, development and operation of the network sits with the owner of the asset.
16. Consequently, wherever the role of RSP eventually resides, it should not be in a position to overstep its legitimate remit and begin instructing what a DNO must do on its network. The RSP would set out the framework and identify a need – verified by stakeholder engagement – and

the DNO would work with that strategic plan to develop the most efficient network plan for its network.

17. If the FSO, and the RSP responsibilities, is set out as specified, and DNOs retain the responsibilities for planning and operating the network in line with scenarios set out by the FSO, there is little need for Archetype 1.

Although the provision of electricity distribution services does not meet the criteria for competition, Ofgem can make full use of the RIIO principles to allow customers to benefit from effective competition.

18. DNOs should not compete for projects relating to the maintenance of the networks it owns and is responsible for – these responsibilities are in place due to the nature of the goods and services provided, which is optimal for one entity to provide due to the economies of scale.
19. Electricity distribution projects are typically smaller and less likely to justify the administrative expense of a bespoke Ofgem led competition process. The systems are also significantly more meshed and overlapping, making it more difficult to identify assets that are sufficiently separable that clear ownership and operational boundaries could be established.
20. Also, if IDNOs and similar parties were to compete for big projects, Ofgem would have to subject these parties to the same regulation DNOs face. This is not the case currently.
21. Competitive tendering of DNO services would therefore not be in the customer's interest in the long term as the network services DNOs provide are not efficiently replicable; effective competition through ex ante regulation brings about the lowest cost for customers in this sector through the revelation of new information and innovation.
22. Customer's do receive the benefits of competition where it is possible in electricity distribution. For example, there is already extensive competition in construction of network extensions to serve new connections and in ongoing ownership and operation of these and there is extensive competition through design and procurement of network solutions¹.

Ofgem should not move to increased ex post review. Digitalisation will not remove the need for incentive-based regulation.

23. The consultation suggests that ex post review could be used for business-as-usual costs, or for the price control as a whole – under Archetype 3. Such movement to an ex post monitoring regime would be very costly as it would harm investment and innovation at a time when it is critical to delivering net zero.
24. The risk of ex post disallowances would be unattractive to investors as it introduces uncertainty around capital investments as well as removing the strong incentives driven by an ex ante approach for network companies to efficiently reduce costs or seek new innovations.
25. Furthermore, ex post review may not deliver the simplicity Ofgem is looking for. In fact, it is likely to be more complex given the reporting and assessment mechanisms that would be required for any ex post assessment. Ofgem would also need to ensure that networks have the

¹ 80% of Northern Powergrid's direct operational workload consists of bought in goods, services and materials; the majority of which is tendered. This means that a large majority of the works that we deliver are already exposed to market forces.

right to challenge its assessment, otherwise the networks could fall victim to misunderstanding, mistakes or simple information asymmetry.

26. Therefore, ex post assessment is not likely to reduce the cost of regulation and would likely result in duplication.
27. A real risk with the Archetype 3 is over-confidence in data availability and Ofgem's ability to use it properly such that Ofgem removes information asymmetry. Network companies already report a vast amount of information across all cost and output areas, which Ofgem receives regularly, yet this has failed to mitigate Ofgem's concerns around information asymmetry. It is not clear how more data would do that.
28. Much of what is perceived as information asymmetry is the natural consequence of an external body regulating a long-standing organisation with expertise in delivering the services it provides. There is inherent experience, intelligence and insight in the network companies that has built up over decades that the regulator does not and could not reasonably possess. More data will not correct for this.
29. In fact, the belief that more data will correct for this asymmetry is potentially dangerous. The requirement to produce the information is costly and time consuming for networks and Ofgem – or the FSO – is unlikely to have the capacity or capability to carry out the necessary analysis that merits the increased reporting requirements. The outcome of too much information that is inadequately analysed will result in poorly formed, ex post judgements that could be costly for the network company, its customers and its investors.
30. Ofgem seems to see information asymmetry as network companies withholding information in order to outperform, which leads to micromanagement to prevent outperformance. Ofgem seems to be overstating the extent to which asymmetry is the problem, when in fact in some important cases, the problem is "symmetrical uncertainty" regarding new information and innovative techniques that network companies have not yet realised. This information is unknown to all parties at the time of business plan submission and is revealed when ex ante allowances incentivise companies to discover new cost-effective innovations to outperform cost these allowances. This is good outperformance and should be encouraged by Ofgem, as it is in customers' interests.

2. Detailed responses to the questions

Q1. What should the role of the 'consumer voice' be and through what institutions and processes should it be channelled?

31. The consumer voice is essential in shaping network company plans – Northern Powergrid took on board 63,000 stakeholder interactions as it produced its RIIO-2 plan. Consumer panels, customer research and co-creation focus groups enabled customers and wider stakeholders to design the plan they would like to see delivered in the coming period.
32. Ofgem has progressively increased the consumer voice throughout RIIO; the creation of the Customer Engagement Groups (CEGs) played a significant role in the RIIO-2 reviews in assessing the effectiveness of company stakeholder engagement. These engagement challenge groups could maintain their remit of holding organisations to account for the approach taken and ensure plans continue to be stakeholder-led.
33. However, there are drawbacks to reliance on stakeholder engagement when it comes to forecasting the 'best view' of the pace of decarbonisation. In the lead up to ED2, DNOs carried out extensive stakeholder engagement separately. Consequently, all DNOs then had different customer and local authority feedback on the 'best view' scenario and all the parameters assumed were therefore inconsistent.
34. Business plan engagement should continue to be customer focused with regards to vulnerability, safety and affordability. But with regards to building a plan that enables net zero, an FSO with a central planning role would set the parameters that network companies would translate into business plans. These parameters should be built on nationwide and regional engagement, allowing customer voice to flow into the planning process through via a common currency.
35. Working in conjunction with this, regional networks should also engage with stakeholders in order to verify that the central planning assumption is representative of the customers and stakeholders served.

Q2. 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?

36. An independent cross sector view is important for driving consistency across sectors in the run up to net zero. We broadly support the proposal to introduce Regional System Planners (RSPs) to be accountable for regional energy system planning activities. New RSPs should be responsible for delivering and applying a consistent planning framework; identifying the societal and customer outcomes all energy networks need to support, consistent long-term cross-vector scenario by region and providing consistent, even-handed analysis of investment options to support Ofgem in decision making.
37. However, a clear delineation of roles, responsibilities and remits are needed for each of the parties.
38. The RSPs should not be responsible for network planning, but responsible for operating a consistent national planning framework that defines clear scenarios across the energy system. This needs to be a careful boundary definition.

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39. Working with the RSPs, DNOs should take this information and efficiently plan and operate the electricity network. Ofgem must ensure that DNOs retain the funding and responsibilities associated with where to build substations, maintaining the health of network and improving performance. It is the DNO (and DSO) that has the obligation to own, operate and optimise the networks at the local level and it is the DNO (and DSO) that has the expertise for optimise at that scale. The FSO would lack the capability and capacity to do so.
40. Similar, wherever the role of RSP eventually resides, it should again avoid seeking to overstep and begin instructing what a DNO must do on its network. The RSP would set out the framework and identify a need – verified by stakeholder engagement and explicitly informed by Local Area Energy Plans (LAEPs) produced by local authorities – and the DNO would develop the most efficient solution. Adopting an industry structure like this means that the plan and deliver model is unnecessary.
41. As Ofgem moves to a model where the RSP sets the national planning scenario, there needs to be appropriate governance in place to address conflicts between the RSP and network companies around that planning scenario. It is appropriate for the benefit of customers that scenarios and assumptions are challenged and refined in order to ensure we arrive at the best outcome.
42. Therefore, it is essential that licence obligations are developed to hold the RSP to account and to ensure that DNO accountability to its customers is not diluted. These conditions should make clear the delineation between energy system planning and network planning, and it must be clear for all parties what escalation routes are available to resolve any disagreements.
43. In the case of a failure to reach an agreement, Ofgem would need to act as the arbitrator between the RSP and network company. The plan and deliver model by its very nature appears to remove this challenge process, and the responsibility for Ofgem to opine on differences of opinion. Both of which are likely to result in sub-optimal outcomes for customers.
44. To be effective in delivering consistent and authoritative analysis it is important that the RSPs are viewed as a national centrally managed function that faces regionally as opposed to being the ‘voice of the region’. Regionally based RSPs will not deliver the consistency and high-quality evidence for the need for investment as a regional office could simply become a cheerleader for local projects. This would perpetuate the issue that Ofgem is actively seeking to resolve. The solve is to set up a centrally managed and regional facing agency where even-handed analysis is undertaken to provide additional support for network investment and give Ofgem the evidence it needs to make funding decisions at a time of rising investment when efficiency needs balancing with growth.

Q3. 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?

45. Market competition is beneficial when a good is efficiently replicable and could be used in sectors where separable large high-value projects are plenty in circumstances where the benefit to customers exceeds the administrative cost. This tends not to be the case for electricity distribution, where the economies of scale mean that it is optimal for a single entity to supply the good.

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46. Electricity distribution projects are typically smaller and less likely to justify the administrative expense of a bespoke Ofgem led competition process. The systems are also significantly more meshed and overlapping, making it more difficult to identify assets that are sufficiently separable such that clear ownership and operational boundaries could be established. Therefore, a move to competitive tendering of DNO services would not be in the best interests of customers in the long term.
47. There are many things to take account of when considering competition versus an ex ante approach, particularly at the distribution level, all of which lead us to discount it as a viable option:
- The regulation of competitors would have to be consistent with DNO regulation, which is currently not the case.
 - Extremely complex DUoS sharing would be required if a winning competitor was only involved in replacing a small element of the network, and the ownership and management of an intermediate asset would reduce the DNOs ability to optimise operations across the entire network.
 - There are likely to be few incentives to innovate beyond what is agreed within an open book contract, as the solution is baked into the contract. Ex ante allowances on the other hand, incentivise companies to find efficiencies throughout the price control.
 - “Build” contracts can lead to the longer term needs of the assets being ignored, such that the initial cost is minimised but the whole life costs are not.
 - Major Projects on the primary network are far more numerous than sectors such as transmission and thus the overhead of competitive tendering would be more burdensome. This could lead to longer lead times for projects and more abortive costs.
 - Prices revealed may not be reflective of actual costs as the market is not perfect, and the mechanism may not achieve the lowest cost for customers due to the ‘winner’s curse’ where the largest overestimation of an item's value wins.
48. Competition cannot – and should not – act as the ‘regulator’ to determine the market price within each electricity distributors region due to the nature of the good provided. There is however scope for the regulator to create effective competition between regional distributors using comparative benchmarking and ex ante incentives, in order for cost effective and innovative solutions to be realised.
49. Competition and ex ante incentives are therefore not mutually exclusive, and the regulator can make use of cost benchmarking and incentive-based regulation to bring about low prices for customers. The RIIO framework has achieved this efficiency and innovation which are key to a successful regulatory regime. These are sound principles that should be maintained in the electricity distribution sector to reap the benefits of effective competition.
50. Competition is present in distribution and is actually incentivised by efficiency drivers inherent in the ex ante framework, thereby allowing customers to benefit from competition:
- There is already extensive competition in distribution, in construction of network extensions to serve new connections and in ongoing ownership and operation of these.
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- There is extensive competition through design and procurement of network solutions.²
- Asset financing makes extensive use of third-party debt, issued on competitive markets.
- Ofgem's benchmarking of asset and finance costs imposes competition between networks.
- Voluntary outsourcing of services and contracts where it is cost efficient to do so. Whether an activity is more cost efficient to outsource depends on the activity and will differ across network companies, and different network operators choose to outsource different activities to optimise costs. These are a direct response to the efficiency incentives in the price cap, that are created through ex ante allowances.
- Tendering for flexibility services will see an increase in the coming period through the DSO function. Ex ante allowances incentivise DNOs to make use of a flexibility first approach where it is more cost-effective to make use of flexibility services rather than putting more copper in the ground.

Q4. 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?

51. We agree that the regulatory regime would benefit from simplification.
52. The RIIO-2 framework has become overcomplicated with high administrative burden. This was largely driven by Ofgem's response to uncertainty in the external environment but the principles of RIIO are not broken; it is the implementation and divergence from those principles that has created issues.
53. Maintaining the strong incentivisation of outcomes will provide the greatest scope to innovate and deliver disruptive change – this is critical for enabling net zero at the lowest cost. To that end, given the success of incentive-based regulation in delivering good outcomes for customers, Ofgem must utilise it as much as possible and consider adapting that framework to include a sensible and proportionate approach to uncertainty.
54. If done with a light-touch, incentive-based regulation allows for mechanistic application of rewards and penalties once the regime is established, which reduces the dangers of regulatory capture, is less burdensome, cheaper to administer while leaving the companies free to manage operations.
55. We believe simplification is possible in the case of electricity distribution in the following areas.
56. The **uncertainty mechanisms** at RIIO-ED2 create a huge regulatory burden - these should be reduced and simplified. The use of a common scenario set by the RSP (potentially within the FSO) would increase the certainty with which ex ante allowances can be set. This will be possible with the properly scoped RSP bringing more certainty as to the period ahead and consistency across business plans, allowing Ofgem to only use in period uncertainty mechanisms where needed for targeted issues.

² 80% of Northern Powergrid's direct operational workload consists of bought in goods, services and materials; the majority of which is tendered. This means that a large majority of the works that we deliver are already exposed to market forces.

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57. Ofgem should carefully consider the extent to which certain costs are predictable or unpredictable and consider different treatments for each. Ofgem recognises the strength of upfront allowances and strong incentives for the predictable costs, such as operations, maintenance and new investment. The existing framework, properly calibrated, allows for regulatory certainty, an equitable Cost of Capital, and the freedom for the DNO to innovate and drive efficiencies and synergies across its business.
58. For those costs that Ofgem does deem to be so uncertain to require an uncertainty mechanism, Ofgem should refrain from overcomplicated mechanisms. These mechanisms must be set out clearly ahead of the price control with a transparent outcome.
59. The **business plan assessment** process could be simplified. Ofgem could continue to utilise business plans as a good way of ensuring stakeholder-led plans are put in place.
60. However, Ofgem should consider its approach to the business plan incentive. For electricity distribution, the RIIO-1 fast-track approach was proven to be flawed and the BPI in RIIO-2 has proven to lack transparency. It makes sense for there to be a judgement about the sufficiency of plans, but Ofgem should reconsider its approach making sure to arrive at something that is consistently applied and understandable to all stakeholders.
61. Ofgem could review and sign off the process in its cost assessment rather than at the level of individual projects.
62. On **cost assessment**, Ofgem should place greater weight on totex benchmarking. This is the most straightforward approach to cost assessment, measuring overall value for money, capturing trade-offs across cost categories, and delivering strong incentives for DNOs to pursue synergies and achieve efficiency improvements. It would also avoid the significant regulatory burden and transparency issues experienced during the RIIO-2 price controls.
63. With regards to a potential split between business-as-usual and non-business-as-usual costs, we do not believe such a split is practically possible in electricity distribution due to the nature of the work done – i.e. many small, intertwined projects. In electricity distribution, we already have separation criteria for totex exclusions that captures bespoke and non-benchmarkable items. These criteria set a high bar for exclusions to keep ringfencing at a minimum as it can dilute efficiencies. Costs shouldn't be separated if they are complementary; if the costs can be traded off against one another, they should ideally be in the same pot to allow companies to manage operations and find optimal solutions. This scope for cost substitution and optimisation is very large in some networks, particularly distribution networks.
64. Ofgem's consultation refers to non-business-as-usual costs as being one-off projects, however the associated working groups suggest that Ofgem is instead contemplating a totex excluding load vs load split for electricity distribution, where one pot could be subject to ex post review. A move away from a Totex cost assessment would harm incentives and would not be in the interest of customers.

Q5. 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?

65. There are examples of successful targeted ex post monitoring – such as visual amenity and worst served customers in electricity distribution. These are focussed activities that provide significant customer benefit with low necessity to innovate around the solution – therefore the use it or
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lose it allowance ensures that these benefits set out at the settlement are provided through the period.

66. However, the bulk of the price control should remain as ex ante allowances to incentivise innovation. Movement to an ex post monitoring regime would be very costly as it would harm investment and innovation at a time when it is critical to delivering net zero.
- The risk of ex post disallowances is unattractive to investors as the best that can be earned is the rate of return.
 - If the regulator controls profits, network companies have no incentive to reduce costs or to introduce an innovation. The lack of efficiency challenge in this model creates a perverse incentive around efficiency and risks the delivery of fatty plans and higher bills.
67. Ofgem suggests that digitalisation will enable it to perform an ex post review as information asymmetry between the regulator and network company will vastly reduce. We disagree.
68. A real risk with the Archetype 3 is over-confidence in data availability and Ofgem's ability to use it such that Ofgem removes information asymmetry. Network companies already report a vast amount of information across all cost and output areas, which Ofgem receives regularly, yet this has failed to mitigate Ofgem's concerns around information asymmetry. It is not clear how more data would do that.
69. Much of what is perceived as information asymmetry is the natural consequence of an external body regulating a long-standing organisation with expertise in delivering the services it provides. There is inherent experience, intelligence and insight in the network companies that has built up over decades that the regulator does not and could not reasonably possess. More data will not correct for this.
70. In fact, the belief that more data will correct for this asymmetry is potentially dangerous. The requirement to produce the information is costly and time consuming for networks and Ofgem – or the FSO – is unlikely to have the capacity or capability to carry out the necessary analysis that merits the increased reporting requirements. The outcome of too much information that is inadequately analysed will result in poorly formed, ex post judgements that could be costly for the networks, its customers and its investors.
71. Ofgem seems to see information asymmetry as network companies withholding information in order to outperform, which leads to micromanagement to prevent outperformance. Ofgem seems to be overstating the extent to which asymmetry is the problem, when in fact in some important cases, the problem is “symmetrical uncertainty” regarding new information and innovative techniques that network companies have not yet realised. This information is unknown to all parties at the time of business plan submission and is revealed when ex ante allowances incentivise companies to discover new cost-effective innovations to outperform cost these allowances. This is good outperformance and should be encouraged by Ofgem, as it is in customers interests.
72. Even so, we do not believe that digitalisation will practically allow for an ex post review. A real risk with the third archetype, is that the available data would be insufficient to provide sufficient learning to give both DNOs and the regulator confidence in how an ex post approach could operate successfully.
73. RIIO-ED2 will be a period of evolving capabilities with:

- network investments justified by better informed forecasting;
- more network data will become available and accessible as monitoring is installed and portals established through visibility, DSO and data strategies; and
- investment planning will be refined by the improved understanding the measurements will provide in previously static areas of the network.

74. However, only a small part of the network will be covered and there will be gaps in both data and capabilities necessary to support an ex post approach. Although monitoring will be deployed strategically in ED2 to provide measurements for the most highly utilised network assets, approximately three quarters of Northern Powergrid's 60,000 distribution substations would not be captured in the data reporting. Also, the data would not give Ofgem the complete visibility of network required to see complex engineering decisions, and so may disincentivise the use of complex solutions despite them being optimal, in order for receive 'good marks' from the ex post review. This would put at risk the delivery of timely network investment necessary to achieve net zero ambitions in the most cost-efficient manner.

75. In order for complex investment solutions not to be dismissed by an ex post review, network companies may have to provide detailed, resource intensive justification to validate these solutions and compensate for the lack of visibility of the project's viability through the simple before and after measurements of the data reported. This may also discourage DNOs from employing elaborate and smart solutions. In addition, regulator checks could duplicate significant analysis effort based on incomplete publicly available datasets making it difficult to duplicate and validate DNO choices. Ofgem would then be implementing a more resource intensive regime, despite the desire to simplify the cost assessment.

Q6. 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?

76. It is sensible to consider the alternative models in those cases where very large, bespoke, lumpy investments are involved. These must be physically separable from the existing network and attract a large enough pool of competitors. In these cases, there is scope that a different model might be beneficial.

77. Where the outputs can be specified with confidence, and there is scope for comparative efficiency tests, Ofgem should maintain ex ante incentive-based regulation.

Q7. 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?

78. Incremental change and simplification to the current regulatory framework is the most feasible option to achieve ahead of RIIO-ED3.

79. We believe that a properly scoped RSP (potentially within the FSO), as described in our response to question 2, would be beneficial to the electricity distribution price control. The RSPs could provide a consistent planning framework to ensure consistency and coherence to DNO investment plans. This would give DNOs a common scenario to work with and allow Ofgem to move to simplified ex ante incentive regulation with lessened reliance on ex post review.

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80. Broadly, planning for RII0-ED3 will commence in 2025. Distributors must have a clear regulatory framework, and clear roles within that framework to plan against. Dependant on the change, it seems unlikely that these significant changes will be defined, agreed and implemented ahead of this date.
81. In terms of the 'Plan and Deliver' archetype, the RSPs will need to be established and carry out significant work before a consistent planning scenario can be achieved. This risks duplication of planning work and abortive costs, as network operators will have had to have started their own planning activities.
82. Beyond the duplication risk that implementation of the RSPs could create, the competitive tendering element of the 'Plan and Deliver' model would create a significant burden on both Ofgem and the network operators. Major Projects on the primary network are far more numerous than transmission and thus the overhead of competitive tendering is more burdensome. This could lead to longer lead times for projects and more abortive costs.
83. As outlined in our response to question 5, the additional network monitoring required to record Ofgem defined outputs to justify ex post assessment will not be in place ahead of the ED3 period, and so a move to the 'Freedom and Accountability' archetype is not feasible.

Q8. 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?

84. It is sensible to consider the alternative models in those cases where very large, bespoke, lumpy investments are involved. These must be physically separable from the existing network and attract a large enough pool of competitors. In these cases, there is scope that a different model might be beneficial.
85. Where the outputs can be specified with confidence, and there is scope for comparative efficiency tests, Ofgem should maintain ex ante incentive-based regulation.

Q9. Should there be a shorter-term price control in gas distribution and/or gas transmission, and how could this work in practice?

86. An extension of three years for gas distribution and gas transmission would allow for the 2026 government decision on heating homes to be worked into the price control review.

Q10. 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?

87. Electricity distributors are the enablers of decarbonisation. It is therefore imperative that network operators maintain the ability to attract that capital whilst avoiding unnecessary costs caused by the heightened risk associated with a major change to the framework, which could prove counter-productive to the delivery of net zero.

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88. In addition to clarity and certainty of price control incentives, it is essential that investors have certainty that their investment will be returned and compensated at an appropriate cost of capital.
89. The approach to establishing the appropriate cost of capital is long-established, and it is this predictability that is valued by investors. Now is not the time to be changing this.
90. Ofgem should not go down the granular project by project WACC route. These are essentially mini price control for mini assets; single entity financing would be lost and there would be a risk of gaming the mechanism. This proposition goes against the overarching aim of this consultation to simplify the price control frameworks, not to further complicate them.
91. Ofgem also need to ensure that the financeability of the organisations are assessed at the licensee level to ensure that the company can operate. This is important for the DNOs, as we are entering a period which will require equity investment, either through reduced dividends or equity injection. This in part of driven by the move to 45-year asset life which commenced at the start of RIIO-ED1. An area that Ofgem should review as a priority.

Q11. Do you have any views on our proposed analytical approach?

92. It is logical to use RIIO-2 as the reference point. Any movement away from the RIIO-2 framework to make use of elements of the archetypes in places must not be a retrograde step from the current framework.
93. Ofgem is right to consider whether any movements away from RIIO-2 would actually bring about a net benefit, but it must assess the archetypes on a sector-by-sector basis. Ofgem must be prepared to make different decisions on the optimal regulatory framework in each sector to ensure the best outcome for customers across the sectors.
94. Considering customer interests with regards to prices, quality, low-cost decarbonisation, and security of supply when assessing options for regulation is appropriate. When assessing the net benefits of each archetype, Ofgem should also ensure it takes a principles-based approach.
95. We have worked with the ENA to develop an assessment guide for the three archetypes, including the principles for use that can be found in full in the ENA consultation response. In summary:
- **Archetype 1: Plan and Deliver**
 - The precise scope of FSO and RSP roles are subject to separate consultation. However, if applicable this will add most value when applied to large, strategic needs and projects.
 - **Archetype 2: Ex Ante Incentive Regulation**
 - Should be deployed where sufficient data is available regarding current performance or current and future costs.
 - Incentivisation of outcome delivery should be used where desired outcomes can be articulated and measured as this leads to incentives both to innovate in delivery of outcomes as well as incentives on timeliness or efficiency of delivery.

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- However, where desired outcomes cannot be articulated, incentivisation of delivery of outputs or inputs provides a suitable approach, especially when accompanied by mechanisms to test that delivered inputs or outputs were appropriately targeted at desired outcome.
 - **Archetype 3: Freedom and Accountability**
 - Where one or more of the following circumstances exist:
 - Activities where there is a need for delivery at pace, but lower concern about the efficiency of the activities, and no need to innovate in solutions e.g. cyber security;
 - Activities where we need to “learn by doing” – where there is no track record to provide data on which to base other regulatory approaches;
 - Activities where there is considerable uncertainty regarding the cost of the project, for example due to technical solution uncertainties and risks or the availability in the supply chain causing material uncertainty regarding future costs, but where the need for the project is certain; or
 - Activities where stakeholders are best placed to define desired activity and where unit cost is secondary to stakeholder-specified outcome e.g. undergrounding for visual amenity.
96. Ofgem must be mindful of the boundary distortions that the different archetypes can make when used in the same framework.
97. In terms of the regulation of electricity distribution, the use of these principles and customer interests criteria points to simplified ex ante incentive based regulation.
- Ofgem already makes use of Archetype 1 in electricity distribution where it is possible and beneficial to customers, through connections competition. The remainder of our operations are meshed small interacting projects, which are not separable and best regulated ex ante to keep bills low.
 - The use of the RSPs (potentially within the FSO) to provide a long-term investment plan would allow for a coherent set of plans from DNOs. RIIO-2 was lacking this and the inconsistent plans caused issues – the use of a common scenario would be beneficial to customers and improve on RIIO-2. This is an aspect of Archetype 1 that would be beneficial to electricity distribution but stressing the boundary issues raised in our response to Q2.
 - Ofgem already makes use of the ex ante element of Archetype 2 in electricity distribution. The RIIO framework has proved itself to be successful in our sector. Ex ante incentives are required to achieve the efficiencies and innovation required to deliver decarbonisation at the lowest cost whilst keeping bills low.
 - Ofgem already makes use of Archetype 3 ex post review in electricity distribution through the uncertainty mechanisms. These are already too extensive at RIIO-2, and further reliance on ex post review would harm the incentive to innovate and would not bring about low-cost decarbonisation. Instead, RIIO-2 would be improved upon if the ex post review was more targeted and limited.
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98. Ofgem is wise to be mindful of the of the benefits of incremental versus more fundamental change across targeted areas of the network. Investors must not be unsettled by fundamental changes to the framework – now is not the time for fundamental change and the success of RII0 doesn't point to this. Investment in the electricity distribution sector will be critical to achieving net zero at the lowest cost; investor confidence must be built on, not unsettled.