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Dear Jane and Gavin,

**SSEN Distribution response to the Consultation on frameworks for Future Systems and Network Regulation (FSNR)**

1. SSEN Distribution welcomes the opportunity to respond to Ofgem's consultation on frameworks for future systems and network regulation. This response is on behalf of Scottish and Southern Electricity Networks' two distribution licence holders: Scottish Hydro Electric Power Distribution plc and Southern Electric Power Distribution plc.
2. With a network reach to over 3.8 million households and businesses in the North of Scotland and Central Southern England, we are a significant stakeholder in the sector and our commitment to delivering the Government's net zero strategy, working alongside Ofgem and our stakeholders is one that remains unwavering.
3. SSEN is also part of SSE PLC, one of the largest publicly listed companies in the UK, and the largest company headquartered in Scotland. SSE is the UK and Ireland's national clean energy champion and has committed to invest over £12.5bn into the economy as part of its Net Zero Acceleration programme by 2026.
4. The key points of our response are included in this cover letter. Detailed responses to the questions set out in the consultation are provided in Appendix 1.
5. This response must be read in conjunction with our response to the recent consultation on the future of local energy institutions and governance, which closed on 10 May 2023. There are clear interactions between Ofgem's proposed Regional System Planner (RSP) role, to be taken on by the FSO, and the FSNR document, but also differences in how Ofgem describes the role. Our responses to these two consultations are part of a wider programme of work SSEN Distribution are carrying out to accelerate net zero in RIIO-ED2 and into the next price control.
6. While the RIIO-2 price control setting process is now complete across all sectors, we are still only in the second month of the RIIO-ED2 price control. **There are several critical uncertainty mechanisms that will need to be activated in-period**, and it is imperative that these are resourced, from both a DNO and Ofgem perspective, such that investment is not delayed. We also encourage Ofgem to consider how some of the feedback we provide in this consultation response could be applied in the context of these upcoming RIIO-ED2 decisions.
7. As we transition to net zero, independent, evidence-based decision-making that looks beyond short-term bill impacts towards long-term societal value will become even more critical. We are broadly supportive of the direction of travel set out in the recently published draft Strategy and Policy Statement (SPS) for energy policy in Great Britain.<sup>1</sup> While the SPS is still subject to consultation, Ofgem must consider how the overarching strategic priorities and emphasis on the need to facilitate strategic investment can be implemented in practice through the

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<sup>1</sup> [Strategy and Policy Statement for Energy Policy in Great Britain](#), May 2023

regulatory framework. With the introduction of the FSO, greater clarity will also be required on emerging roles and responsibilities, and interfaces between different bodies.

### Supporting net zero targets and promoting growth in the economy

8. We are moving from a period of low growth and steady network development to very high growth and accelerated network development as we transition rapidly to net zero. Significant investment in the electricity network infrastructure is required to deliver the network capacity needed to allow net zero targets to be met and unlock the wider societal value that net zero will deliver.
9. The future regulatory framework must be aligned with the UK and Scottish governments' net zero targets and enable our local communities to meet their net zero ambitions. At the same time, the regulatory framework must take a longer-term view and recognise the wider societal value that net zero will deliver. As highlighted in the recent Powering Up Britain report, *"Decarbonising the power sector whilst meeting a potential 60% increase in electricity demand, by the middle of next decade, has the potential to bring forward £275 – £375 billion of investment from both the private and public sectors. Reinforcing the onshore electricity network could support 20,000-80,000 jobs by 2037, in addition to providing further employment in the supply chain."*<sup>2</sup>

### Key considerations for the future regulatory framework

10. With these wider objectives in mind, our view is that any future regulatory framework must:
11. *Deliver timely investment in local networks:* we are only two five-year price controls away from government targets for a net zero electricity system and a net zero economy. Most assets we install on our network today will still be in operation in the 2050s. The next price controls must proactively support ongoing acceleration in delivering network capacity to deliver decarbonisation and facilitate economic growth. While we have seen some positive steps in RII0-ED2, too much focus has been placed on keeping costs low for current customers, without sufficient consideration to the wider societal impacts and longer-term costs of delaying investment in the network. As noted by Dieter Helm, *"the consequences of too few networks are much, much worse than having too many; the balance is asymmetric. If the networks are not sufficiently developed, there will be no net zero."*<sup>3</sup>
12. *Reflect a change in mindset and incentivise long-term investment:* at transmission level, we have seen positive recognition of the need to take a strategic approach to net zero investment. This is critical and will have positive implications at distribution level as well, enabling distribution-level customers to connect more quickly to our network. Collectively, however, we need to consider how such a strategic approach can now be applied at distribution level. This is necessary to ensure we can (i) take a proactive approach, and (ii) go beyond making incremental investments to our network. This is key to meeting net zero targets and unlocking wider socio-economic benefits. In particular, the price control methodology must evolve to reflect the need for greater investment in the networks, ensuring that companies are not penalised through the cost assessment process for making decisions that are more efficient in the longer-term but could increase costs within period.
13. *Attract investment:* given the significant level of investment required in the electricity infrastructure to deliver net zero, providing a stable and predictable regulatory framework is critical to attracting investment, in particular in the context of global competition for resources and funds. With global competition, decisions in the energy sector will further influence confidence in investment across other sectors such as the nuclear and water industries. The regulatory framework must therefore provide investors with a competitive rate of return that is reflective of the risk profile of investments within energy networks. This should be competitive with a range of comparator sectors and international regimes as well as ensure that shareholders and debt holders are adequately compensated. Ofgem is also still exploring potential changes to the treatment of inflation under the price control: this could

<sup>2</sup> [Powering Up Britain policy paper](#), March 2023

<sup>3</sup> [Dieter Helm, Energy network regulation failures and net zero](#), 5 January 2023

fundamentally change one of the key pillars of the regulatory framework, increasing costs for customers in the long run, yet appears to be considered completely independently from this review.

14. *Ensure financeability*: when developing the regulatory framework Ofgem must ensure it maintains its statutory duty to ensure companies remain financeable undertaking financeability stress testing analysis for the short, medium and long-term considering the “whole business” and associated risks. The framework must avoid a fragmented and inconsistent approach to setting financial parameters across each archetype decision unless supported by clearly demonstratable evidence. Also, assessing financeability from an overarching view and over the longer term will ensure the impact of short-term price control decisions does not have a detrimental effect on future consumers. As per paragraph 12, the financial framework must also be competitive and attractive to ensure the energy sector is attractive for investment to support the delivery of net zero.
15. *Be proportionate and remove unnecessary complexity*: the current price control setting process is too lengthy and complex, with a significant resource burden for network operators, stakeholders and Ofgem. For certain activities such as asset replacement and inspection and maintenance, the regulatory process should be lighter touch and focussed on assuring the overall approach rather than project-level approval by Ofgem. Issuing a clear business planning guidance document early in the process could further help significantly simplify the process and provide clarity to companies and their stakeholders on the baseline expectations to be met.
16. *Be coherent*: there are several on-going activities across Ofgem and Government, including for example work on DSO governance, charging arrangements, and the Government’s review of economic regulation. Each is considering fundamental changes to the overall regulatory framework and as such, cohesion across the various initiatives in terms of overarching strategy and direction of travel, decision-making, as well as timescales, is essential. A piecemeal approach to industry change will lead to negative outcomes for consumers.
17. *Define clear roles and responsibility and include an appropriate right to appeal*: the roles and responsibilities, of government, Ofgem, and the FSO (once introduced), must be clearly defined. Responsibilities for decision-making must be clearly set out and Ofgem must remain the decision-maker on regulatory matters. Linked to that, the appeals process is a fundamental part of any credible regulatory regime, and this appeals process must be based on the merits of this issue, with a thorough and substantive review of the issues. This is essential to retain the confidence of investors in the regulatory framework. Currently, it is unclear how Archetype 1 and Archetype 3 in particular would meet this criterion.

### Overarching feedback on consultation

18. One of our most significant concerns is the **risk of delay and distraction** that some of the more fundamental proposals under this review could cause. The price control framework must facilitate investment in the network at the right time, removing blockers and bureaucracy in the process. There is a real risk that this process, if not well-targeted, could prove a distraction at a time when all industry parties must be working with a common mindset and a clear focus on delivery on the infrastructure needed to enable the transition to net zero. Importantly, whatever the shape of the future price control framework, Ofgem must have the right capabilities and resources to effectively to deliver under it.
19. **The challenge we face in delivering the scale and speed of investment needed must not be underestimated.** This is further exacerbated by global competition for resources and funding for net zero, as well as supply chain constraints. The recent report by the Climate Change Committee<sup>4</sup> highlights that delivery and deployment of infrastructure must be achieved at a much greater pace than the present regulatory regimes can achieve. This clearly demonstrates the extent and pace speed of investment needed. Ofgem’s review must focus its efforts on improving and strengthening areas of RIIO that require it without risking the delays and distractions that a wholesale review would bring. Focus on delivery is key, and there is a real risk that an overhaul

<sup>4</sup> [Delivering a reliable decarbonised power system, March 2023](#)

of the regulatory framework could create uncertainty for investors at a time when significant investment in electricity infrastructure is needed.

20. The consultation is focussed on electricity transmission and gas, with only brief consideration of if and how the proposals could apply to electricity distribution. **Further work will be required in the run-up to the next electricity distribution price control to develop a suitable framework, including a detailed impact assessment.** Different sectors face different challenges and the framework for gas and electricity transmission is unlikely to be appropriate for electricity distribution. In particular, DNOs will need to invest significantly at the low voltage levels, and Distribution System Operation (DSO) roles and responsibilities are continuing to evolve. In addition, RIIO-ED2 has only just started, and a detailed review of what has and hasn't worked well is key to ensuring we learn lessons from this process and focus the fixes where they are required. We would ask for a timescale for the electricity distribution framework to be made visible at the earliest opportunity.
21. In addition to the wider strategic areas that are considered in the consultation, we are disappointed that the **existing and well-known challenging policy issues** that we flagged in our response to Ofgem's September FSNR open letter have not been acknowledged. This review provides a prime opportunity to ensure these longstanding issues, which include losses and reviewing the regulation of IDNOs, are fully resolved, and we would urge that these are given the appropriate focus.
22. We note that **little provision is made for the role of innovation within the consultation.** Innovation remains an essential part of the regulatory framework ensuring that network operators continue to look at new and innovative solutions which will result in lower costs and carbon reduction in the long term. The innovation mechanisms restrict innovation projects to those that payback within the five-year regulatory period, with no incentive to look at innovation that will address emerging issues but have a longer-term return.
23. We fully support digitalisation and utilising more efficient means of data sharing. However, we would caution that this work is still at an early stage, and we are a long way from being in a position to rely on digitalisation to fundamentally change the way that we are regulated.

#### Initial feedback on archetypes and potential application to electricity distribution

24. **We consider that the principles of the RIIO framework continue to provide broadly the appropriate grounding** to ensure that the industry can meet the accelerating pace of change in electricity distribution networks. A version of the RIIO framework with appropriate adaptations will ensure that network operators are able to invest to ensure that the network is ready to enable net zero, whilst at the same time ensuring efficient costs for customers today and tomorrow. Lessons should be learnt from RIIO-2 to inform adaptations that are needed for the next price controls, and we would note that certain aspects already appear as we move into this rapid transition phase. Rather than reconsidering the entire price control framework, the focus should be on individual mechanisms within RIIO that can be improved to ensure that regulatory funding mechanisms are slick and streamlined, avoiding unnecessary complexity and bureaucracy.
25. It is highly unlikely that any single archetype would be suitable as a replacement to the current regulatory framework. Rather, **different archetypes could be used to build on different components of the existing regulatory framework.** This must be achieved without compromising overall certainty to investors, by ensuring certainty and transparency on how the various components will apply.
26. We note that Ofgem has discounted negotiated settlement as a specific archetype. Our view is that stakeholder and customer engagement is a critical part of the process. We engaged extensively throughout the RIIO-ED2 process, and stakeholder engagement is now embedded in our business-as-usual activities. However, it was unclear how this extensive engagement was taken on board by Ofgem in its own decision-making. This has put some activities which received strong stakeholder support at risk, for example the replacement of fluid-filled cables, which pose a significant environmental risk. Ofgem must therefore set out a clear and transparent approach for taking into account stakeholder views.

#### Archetype 1 – Plan and Deliver

27. There are extensive interactions between the proposals set out in the FSNR consultation and those in Ofgem's consultation on the future of local energy institutions and governance, most notably in relation to the proposed Regional System Planner (RSP) role and its link to Archetype 1. We note that this FSNR consultation does appear to take for granted that (i) an RSP role will be introduced at the distribution level, (ii) the Future System Operator (FSO) would take on this role. However, Ofgem has yet to reach a decision on this, or produce an impact assessment.
28. We are supportive of a regional planning system that is democratic, transparent, and centred on the needs of local communities, but avoids the need for additional and unnecessary complexity. We have previously stated a need for localised, cross vector coordination with a strong focus on democratisation, and we consider this role is better described as a 'Regional Energy Coordinator' (REC). By bringing key stakeholders together and democratising the process, a REC can serve to modify or add to the network requirements we plan for to help us better meet the whole energy system needs of our communities.
29. With regards to how the FSNR applies this model under Archetype 1, we are concerned at the proposed significant extension of the FSO's remit to include an active role in both planning and delivery functions, which potentially goes beyond what is articulated in Ofgem's consultation on local governance. More generally, duplication of the planning role is not in the interests of customers and our view is that network operators, in combination with local stakeholders, are in the best position to carry out this function. Similarly, it should be the responsibility of the network operator to determine the appropriate means to deliver the outcome needed to meet regional plans.
30. Regardless of the chosen model, timely implementation, and clarity on the roles and responsibilities of each body will be key in ensuring a functional model. Please refer to our response to the consultation on the future of local energy institutions and governance for full details.
31. While we have concerns with how Ofgem is articulating the role of the FSO, we consider that archetype 1, if well executed and aligned with our proposal for a REC, could help unlock net zero at the local level, for example by targeting larger, higher voltage load-related activities. It could enable strategic investment in our networks in alignment with local stakeholder ambitions, as well as simplify and streamline the use of uncertainty mechanisms. In the context of our SHEPD region, we would also be open to exploring how a plan and deliver model could support delivering whole system solutions for our most remote island communities.

#### Archetype 2 – Ex-ante regulation

32. We consider that ex-ante regulation has delivered considerable benefits for consumers. As such, we do not consider that the case has been made for fully moving away from an ex-ante regulation model as the starting point for the next set of price controls.
33. We consider that there would be some benefit in exploring a simplified approach to what Ofgem refers to as "Business as Usual activities" (BaU). Our view is that regulation in this case should focus on ensuring a robust and transparent decision-making process is in place, rather than a scheme-by-scheme justification. This could potentially apply in the context of asset replacement and refurbishment activities.
34. However, it is critical to remember that even BaU activities can see significant step changes in investment required, for example as specific asset classes all reach end of life at a similar point in time. This is the case for example of our fleet of underground cables in our SEPD region. Uncertainties can also be present, for example in dealing with diversions associated with wayleave termination. Finally, further consideration must be given to different types of costs and activities in each sector. For example, DNOs will see a significant increase in work required at low voltages, which will present different opportunities and challenges compared to other sectors.



35. We have significant concerns with Ofgem's proposal to "increase the use of ex post productivity-based cost assessment mechanisms within an overall, ex ante, framework." This could create significant complexity, result in retrospective regulation, and risk deterring investment and increasing costs to customers in the longer-term.

Archetype 3 – ex-post regulation

36. Under Archetype 3, Ofgem proposes an ex-post regulation model. There are elements of this approach that are worth exploring and could deliver significant benefits, including the simplified upfront process and the freedom for network operators to determine when and where to invest in the network and the best way to deliver outputs.
37. However, if not properly implemented and genuinely light touch, this approach could create significant uncertainty, additional complexity, deter investors and increase costs for customers in the longer-term. It is also essential that any review considers whether costs were efficiently incurred at the time and not with the benefit of hindsight.
38. Further work is required to explore whether the benefits that could be gained by this approach could equally be delivered under Archetype 2, with appropriate modifications to the RIIO framework to reduce the upfront regulatory burden and rigidity in the uncertainty mechanisms to allow more flexibility in the delivery options.
39. We look forward to engaging with Ofgem, industry and our stakeholders as we prepare for the next set of price controls. If you have any questions in relation to our response, please do not hesitate to contact me.

Your sincerely,

Clothilde Cantegreil

**Head of Strategy – SSEN Distribution**

## Appendix 1

### 1. What should the role of the ‘consumer voice’ be and through what institutions and processes should it be channeled?

The role of the consumer voice and stakeholder voices will be more important than ever in the next price control as we take a whole system approach to delivering net zero at the local level. Price controls can be a complex and technical area and as such, engagement with consumers and stakeholders needs to be tailored and targeted to the areas of interest for the different stakeholder groups. Stakeholder engagement was an integral part of the RIIO-ED2 business planning process for DNOs, with some groups such as the Customer Engagement Group (CEG) being very well utilised to inform decisions on key areas of the business plan. However, the role that this engagement played in Ofgem’s decision-making when it came to the Draft Determination and Final Determination is unclear. This aspect did not work well in RIIO-ED2 which was a cause of frustration given the amount of time spent both by DNOs and stakeholders on ensuring that stakeholder views were built into our business plans. We consider this to have been a missed opportunity for stakeholders to have a real input into the decisions influencing the development of the electricity distribution infrastructure over the RIIO-ED2 period.

The framework for future price controls must include a well-defined process that sets out how Ofgem will account for stakeholder views and feedback, including where Ofgem disagrees with stakeholder views and why. The thread of stakeholder engagement and views needs to be clear from the beginning of the business planning process right through to Ofgem’s decision making. Early engagement is key to ensure that the consumer voice inputs from the very start, this would avoid issues being raised late in the process when plans are already made, or indeed being heard at an appeal for the first time. Engagement is fully embedded in our day-to-day activities and we are one of the DNOs to have committed to setting up an enduring CEG. Our independent Powering Communities to Net Zero Group (PCNZ) will continue to scrutinise us, critically questioning the delivery of our RIIO-ED2 business plan and providing independent challenge, to ensure that the benefits of stakeholder engagement in our decision-making process continue to be seen during the price control period.

### 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?

#### Definition of role

Archetype 1 is interlinked with the proposals set out in Ofgem’s consultation on the Future of Local Energy Institutions and assumes that there will be a Regional System Planner role, which forejudges the outcome of the consultation. We are also concerned that the remit of the proposed RSP role does not align between the two consultations. In particular under the FSNR consultation, the remit of the RSP role appears to have been significantly extended to include determining the appropriate delivery model. There are multiple reasons why we do not consider that any parties other than DNOs would be in a position to determine the most efficient delivery model. The makeup of the network means that much of the investment required is in lower cost higher volume programmes of activity, particularly at the LV level, which is difficult to separate out to consider alternative delivery models. We would also highlight that a significant amount of work is already tendered out to third parties (see our response to Q3 for more detail on this) and it is unclear what additional benefits would be delivered, particularly given the additional complexity and risk of delay that competition would bring.

The DNO/DSO also currently delivers the system planning function and must continue to do so, holding the key expertise, tools, understanding of our own networks and the accountability to maintain safe and reliable supplies. A new body that supersedes any of these functions would create duplication and confusion on accountabilities, and risk expertise being drained from DNO. We propose an alternative Regional Energy Coordinator role in our response to the consultation on the Future of Local Energy Institutions, which would avoid any duplication whilst providing a democratic body with a localised, cross vector coordination role with a strong input from stakeholders. See our response to the consultation on the Future of Local Energy Institutions for full details of our views on this.

#### Application of archetype

If a Regional Energy Coordinator role was implemented as per our response to Ofgem consultation on the Future of Local Energy Institutions, then Archetype 1 could facilitate strategic investment, by providing a means to align DNO plans with local stakeholder plans and providing independent assurance of DNO plans to Ofgem. Our initial view is that this archetype could potentially apply to higher voltage load related projects and possibly to subsea cable type activities. In our SHEPD area, it could apply to projects such as our whole system approach to the Outer Hebrides

and Orkney, where coordination across multiple parties is key, and where a Regional Energy Coordinator could act as a facilitator across these parties and independently assess the need for the solution, providing independent assurance to Ofgem and allowing us to proceed with certainty.

If this archetype is to be in place in time for the next ED price control period, it needs to be implemented quickly and efficiently. Once a Regional Energy Coordinator is established, initial focus should be on validating companies' business plans in advance of the next price control. Given the short timeframe available, in the interim, Ofgem must consider how to align decision-making with local ambitions, so as not to create unnecessary delays to unlocking net zero at the local level. As an example, we have been working closely with our local stakeholders on the Isle of Wight on a detailed study of future investment needs, to inform our upcoming re-opener submission and develop a set of tools to help support decision-making in uncertainty. These interim steps would be a way to begin to integrate this new body into network operators' plans and could be a steppingstone to a wider focus as per our response to the consultation on the Future of Local Energy Institutions.

### **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?**

Competition is of value to consumers only when realised in a way that avoids unnecessary complexity and enables the timely delivery of network projects, delivery of net zero and the protection of security of supply, reliability and safety. Any future expansion of competition models must not delay expansion of the network and tendering must create net benefits to consumers rather than net costs. Competition must only be implemented where there is evidence that there will be true value for consumers, supported by a robust impact assessment.

At distribution level, we already competitively procure many of our services and we also have legal obligations regarding competitive tendering under the Utilities Contracts Regulations 2016 and the Utilities Contracts (Scotland) Regulations 2016. We also already have extensive competition in place in our connections business, with sufficient levels of competition now deemed to exist in the majority of connection project market segments such that the requirement for a regulated margin has been removed as true competition now exists.

Much of the network expansion that is required at distribution level will be on LV networks, which does not lend itself naturally to other forms of competition. For an activity to be suitable for competitive delivery, we consider it must be a new project that is large enough to be attractive to investors and is physically separable from existing networks. There must be multiple competitors in the market willing to bid for the work to ensure that consumers are truly seeing the benefits of competition.

We would also note that there are existing examples of competition at distribution level that may need to be reviewed in the context of net zero to ensure that there are benefits to consumers in the long term. For example, the framework around IDNOs and ICPs should ensure that the network is being built out to enable net zero, regardless of the party delivering the works. In addition, as noted in our response to Ofgem's FSNR open letter in September, the IDNO regulatory must ensure that appropriate protections are in place for consumers. This has not been addressed in the FSNR consultation and should be considered as part of the ongoing work.

With regards to open book contracting, we note that there are a number of different models that could be considered under this term. Creating long term strategic relationships is already part of our supply chain strategy. This strategy brings higher levels of collaboration with the supply chain which creates increased efficiency and performance. Moving to other models such as alliance and enterprise contracting models could be effective when used in the right circumstances on appropriate programmes and value of projects. Bringing together the right skills, capabilities and behaviours with increased levels of innovation could deliver protection and assurance for consumers. However, all of these models bring about different levels of risk and it would take time to fully understand and evaluate the pros and cons. In any event, it should remain the responsibility of the network operator to determine the appropriate contractual framework in each case.



#### **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?**

Ex ante regulation has delivered significant benefits for consumers, and a version of the RIIO framework will provide the right grounding to allow network operators to invest in developing the substantial infrastructure needed to enable net zero. We agree that options for simplification of elements of the RIIO framework should be considered.

However, the options set out for simplification of regulation under archetype 2 are very varied and each could drive very different outcomes. Careful consideration is needed to the appropriate application of these options to the various activities that network operators undertake. We agree that a reduction in complexity of the current process is desirable. However, we would caution that the devil is in the detail and some areas are unavoidably complex; the desire for simplification must not take priority over ensuring an accurate and robust price control setting process. There are some activities that could benefit from a less involved regulatory treatment, whereby regulatory focus is on the process that the network operator has followed and demonstration of robust and transparent decision-making rather than individual assessment of specific justification cases.

One element of the business planning process that could be simplified is in regards to the assessment process for investment projects, which in RIIO-ED2 required the submission of lengthy Engineering Justification Papers (EJPs). This was a time consuming and resource intensive process, both on our side to prepare the documents and equally on Ofgem's part to carry out these individual project reviews. Our view is that the use of EJPs should be limited to areas where there is a genuine requirement to assess a changing need (e.g. load, linking into Archetype 1). In other areas, the regulatory focus should be on the data underpinning the decision and ensuring there is a robust decision-making process in place.

However, we are concerned that the premise of Business as Usual "BaU" costs has been misunderstood, and indeed that an assessment of a cost category as BaU or non-BaU may be an oversimplification. Many activities that we carry out are part of our core, usual activities. However, the level of activity or investment needed at any one time may not be usual or typical. An example is our fleet of underground cables in our SEPD region, where all are reaching their end of life at a similar point in time, thereby requiring a significant step change in investment. Other activities that we carry out are BaU to us but may not be to other network operators, and as such, benchmarking is likely to be more difficult. An example of this in our SHEPD area is subsea cable replacement.

We disagree with Ofgem's proposed second option which includes the use of 'ex post productivity-based cost assessment mechanisms within an overall, ex ante, framework'. This suggests lengthy ex ante and ex post assessments, creating retrospective regulation and significantly undermining the power of targeted incentives to deliver for customers. This would be hugely detrimental to investment.

We note Ofgem's reference to the Network Asset Risk Methodology (NARM) (paragraph 3.27) and the comment that some network operators consider this approach too onerous. This is an example of an area where the correct approach for electricity distribution may well be different to other sectors. For electricity distribution, there is a single NARM target for our monetised risk reduction that provides the flexibility for us to make the right investments for the right rational at the right time, efficiently. DNOs have put a significant amount of effort into the NARM, which is a now a mature process that is operated consistently across the DNOs. The NARM is highly effective in providing Ofgem with high level control over investment in the network, with an understood and managed methodology underpinning decision making. Our understanding is that the comment noting concerns around an onerous approach may reflect the application of NARM in other sectors, where it is applied at a project level rather than as a single target.

In relation to digitalisation, we fully support further use of digitalisation to simplify and automate elements of the price control process where possible. We would note that there is a lack of clear, central guidance in this area which has led to divergence across the network companies. As detailed in our cover letter, the digitalisation work is still at a relatively early stage, and it would be premature to suggest that we could rely on digitalisation to prop up a fundamental change to the price control process. Work on digitalisation should be targeted on specific key areas where the most benefit is likely to be seen in the near term, with longer term work continuing in the background recognising this is unlikely to feed into the next round of price controls. We note that currently, there is a degree of different approaches being taken by network companies. We understand Ofgem is looking to potentially bring more consistency, for example through its Modernising Energy Data project. Ofgem must set a clear direction travel, and ensure this is supported by sufficient funding. The digitalisation re-opener in particular can be utilised to provide additional funding for activities not catered for in the RIIO-ED2 business plan baseline allowances.

**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?**

Please see our comments in the cover letter on the pros and cons of an ex post monitoring regime. We do see some positive aspects to this approach, such as a simplified up-front process and the freedom for network operators to get on and deliver. However, in order for this model to work there would need to be clearly articulated outcomes and rules governing the ex-post review. The regulator would need to be committed to the framework it has set up and carrying out a light-touch review only, and resist temptation to apply retrospective regulation.

If this is not adhered to then the significant risks would outweigh any benefits. These risks include significant uncertainty for network operators, moving the complex up front process to the end of the period (when justification is potentially more difficult in retrospect) and increasing costs for customers in the long term by creating an uncertain regulatory framework for investors. The benefits of this approach could also be delivered under Archetype 2 if the appropriate modifications are made to the current framework, for example through more clearly defined baseline requirements, outputs and business plan guidance.

**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?**

We have no specific comment on the proposed approach for Electricity Transmission. However, we would note that overall, the consultation appears to have a significant focus on transmission and gas distribution, which has made it more difficult to fully understand the potential application at distribution level. Given the different challenges that are faced in electricity distribution, it is important that this is given detailed specific consideration and we would urge that Ofgem does not consider any decisions made in the transmission and gas distribution sectors as setting a precedent elsewhere. This was an issue that we faced in RIIO-ED2 where, due to the timings of the price control, decisions were already made in a number of key areas which were then assumed to apply to electricity distribution. Examples of this were seen in the licence drafting process, where Ofgem's drive for consistency across the sector meant that some licence conditions were included directly from the gas distribution licence, when the policy debates were ongoing for electricity distribution.

**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?**

The proposals in the consultation are at a very early stage, particularly for electricity distribution, and much further detail is required to enable us to provide a fully informed view.

For electricity distribution, the debate around archetypes is not the right one to be having right now. Our view is that instead the focus should be on how we accelerate investments in the networks in RIIO-ED2, and setting up the future price control framework to allow the substantial investment that is needed in the timescales required to enable net zero. Given that the consultation on the a Future of Local Energy Institutions has only just closed, significant work is also required to further scope out, agree, and implement local governance arrangements,

Ofgem must also carefully consider additional changes in designing the detailed framework to proactively enable net zero. This goes beyond just the consideration of the three archetypes set out in this consultation and requires detailed considerations of the mechanics of a price control, for example cost assessment. In particular, we think further work is required on:

- (i) Building on existing decision-making tools, in particular CBAs, for example to explore Real-Options Analysis, and making sure the costs of delay are appropriately capture.
- (ii) Reviewing the cost assessment and benchmarking process, and finding alternative ways to assess load-related costs to ensure effective and efficient assessment of net zero expenditure.

Consideration of point (i) above should also feed into decision-making around uncertainty mechanisms in RIIO-ED2 as well as into RIIO-3. We are already exploring how new tool could be used to improve how we make decisions in uncertainty and support our upcoming re-opener submissions. With regards to point (ii), baseline allowances in RIIO-ED2 were set based on the benchmarking of cost drivers that only capture current needs, meaning that the cost assessment process cannot assess variations in efficient strategic investment.

As highlighted in our response to Ofgem's open letter of September 2022, there are a number of outstanding known policy issues that have existed for some time and should be resolved as part of the FSNR process. These areas include: addressing network losses; smart metering; reviewing the regulation of IDNO and private wire networks to ensure the framework is fit for purpose and delivers value for money for customers; the PSTN network switch off; and the accidental dependence of water, telecom, transport and social care systems on electricity distribution networks for their resilience.

**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?**

As an electricity distributor, we have no specific comment on the approach to regulation of gas distribution and transmission beyond RIIO-2. However, we would highlight that the challenges faced differ across the sectors and each must be reviewed individually to ensure that the correct framework is in place to address the sector specific challenges. The FSNR consultation document has a heavy transmission and gas distribution focus given the timing of the upcoming price control reviews, and there is significant detailed work to do to establish a framework that is suitable for electricity distribution. Any decisions made for transmission and gas distribution should not set a precedent for electricity distribution, as the establishment of a suitable and robust sector specific framework must be the aim, rather than cross-sector consistency.

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

Please see our response to Q8 above. We have no specific feedback on this, however would note that any consideration of a rollover must also include consideration of resource implications as even a rollover can require significant effort on behalf of network operators, Ofgem, and wider stakeholders.

**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?**

The UK and Scottish governments net zero targets are key drivers behind the significant scale and speed of investment required to deliver these ambitions. Challenges faced by the industry and market condition should not be underestimated when considering the coming price control period. The regulatory framework must ensure financeability first and foremost as its one key priority.

To do this the market must continue to attract appropriate levels of financial capital. The rush to achieve net zero, and away from reliance on hydrocarbons is leading to significant amounts of investment globally. It is therefore paramount the UK continues to remain attractive for investment and a stable regulatory framework is a key enabler. A number of the archetypes set out as options for the future network's framework suggest fundamental changes which will introduce a level of uncertainty. A key focus must be that this uncertainty is not to the detriment of net zero. We need to ask the question – does the risk of changing the price control framework at such a critical time to deliver decarbonisation outweigh the benefits for consumers? If not, then is it worth it?

At a period when such large amounts of investment are required, such uncertainty could unnerve investors from wanting to help fund the change. Change in the framework must be communicated to the market, investors and operators to paint a clear picture of what we are trying to achieve. This will give consistency and certainty over the price control horizon.

To move to an alternative model by the end of RIIO-2 is a large shift in potentially too short a timeframe and may not be the right market to introduce a radically new framework. It may be the timing of consultations and the new framework may not align with planning and engagement for RIIO-3 on the basis this is what the next price control is called. Our overall view on the financial parameters and structure of how to approach the archetypes on a principles basis remain unchanged but the practical process for implementing these archetypes may be challenging. We would be supportive of extensive engagement on the archetypes and the financial framework with Ofgem to ensure this is balanced and robust to underpin the necessary multi-billion pound investment programme.

We believe that there are elements of the existing regulatory framework that can be simplified and made more adaptive to ensure there is a stable and consistent financial framework. With regards to the financial framework, we believe this needs to consider the cost of capital, timing of cash flows through regulatory depreciation, and financeability. Any evolution of the price control should therefore ensure these core elements are central to the creation of any archetypes or price control structures. These financial elements should apply to ex-ante business plans, uncertainty mechanisms, or even separate financial arrangements or vehicles. An example would be what was used for electricity transmission in TPCR4, namely Transmission Investment in Renewable Generation (TIRG), which had a separate rate of return and depreciation profile to that of the core price control. We would welcome engagement on the development of the financial framework in parallel with the archetypes and structure of future network regulation. At this stage, we believe the following principles should be a core element of any financial framework:

- A competitive and attractive financial framework to ensure security of investment to support the sector in delivering its Net Zero targets;
- Maintaining the statutory duty that ensures companies are financeable and considers financeability in the short/medium and long term to ensure short term price control decisions are not creating consumer harm in the future; and,
- Decisions in relation to financial parameters must be taken well in advance of final investment decisions reflective of stress testing of short, medium and long term financeability considering “whole businesses” and associated risks. The framework should seek to avoid a fragmented and inconsistent approach to setting financial parameters across each archetype decision unless clearly demonstrable evidence to justify such a differentiation.

#### Securing Investment to Deliver Net Zero

The financial framework should deliver a competitive and attractive financial framework to accelerate investment and deliver government goals including ambitious net zero targets and energy security. The need for significant unprecedented investment levels is required across the energy value chain in order to achieve net zero ambitions, government system security requirements, and deliver a more affordable energy system for consumers. Therefore, when considering the long-term nature of investment in regulated networks and multiple billions pounds of investment, it is imperative that the financial framework considers short, medium and long term horizons. First and foremost, the framework should ensure competitive returns are provided reflective of the risk profile of investments within energy networks. This should be competitive with a range of comparator sectors and international regimes as well as ensure that shareholders and debt holders are adequately compensated. In recent price controls, i.e. RIIO-2, short term credit financeability of companies has been the primary priority of Ofgem something which was set out in their methodology documents. Unsurprisingly, this has resulted in a short term and narrow view of financeability despite there being clear concerns around the competitiveness of the sector nationally and internationally as well as medium-to-long term credit financeability concerns. This has led to short term bills being the priority at the expense of bill reductions in future price control periods.

Significant progress has been made under the RIIO framework and has delivered significant benefits to consumers. That was underpinned by a longer-term focus on driving incentives and efficiency and providing greater regulatory certainty. For the future of network regulation, it is important that these principles are prioritised to accelerate investment where necessary. Government and industry ambitions to have a decarbonised, secure, reliable, and affordable energy system can only be enabled by the safe operations and major investment in energy networks. When considering a medium- and longer-term view of consumers interests including the impact on consumer bills, accelerating investment in energy networks delivers the largest benefits to consumers. Any new framework or archetypes need to achieve that longer-term benefit through investment underpinned by a stable and predictable price control that considers all elements of an energy network and not a discrete suite of investments or a short time period. It is important to recognise that network investment will deliver all the government priorities which means the future of network regulation must avoid the short-term focus on the energy network component on energy bills.

The future design of energy network regulation should ensure companies are financeable beyond considering a simple credit metric within a short time period. As part of the regulatory framework, Ofgem’s must consider both debt and equity requirements with reference to short, medium- and long-term horizons. Critical to this framework is a comprehensive understanding of risk and the competitiveness of investment compared to other sectors and jurisdictions. For example, the framework should ensure efficient debt costs are fully funded and the return on equity



attracts the investment to deliver net zero<sup>5</sup>. This should be at the forefront for consideration when looking at the different archetypes and making long term decisions. Ofgem need to look at the long-term impact on customers and sustainability rather than making short term plans which will cut costs for the current period but have detriment effects down the line.

The financial framework should ensure that all archetypes are considered as part of financeability requirements as a “whole” over the short and long term. We acknowledge the archetypes currently proposed require further definition in order to fully assess the financial impact and considerations required for the financial framework going forward. Archetype 2 presents a financial framework most aligned to the RIIO structure. Any movement to a financial framework described in archetypes 1 or 3 would result in altering the overall risk profile of the licensee. Given the inherent challenges around quantifying this risk, significantly greater detail is required for licensees to appropriately evaluate Ofgem proposals surrounding financeability.

Changing the overall risk profile of the licensee would require a recalibration of financial parameters (e.g. cost of capital) in the assessment of financeability. However, having separate cost of capitals which may create unintended differences between and within sectors. For example, there is risk that there is divergence and confusion in energy network structures, incentives, and priorities by having multiple frameworks across sectors and areas of the UK. This in turn may create a regulatory framework that is unnecessarily more complex, create a greater potential for fragmentation, and confuse investors, consumers, and stakeholders.

As a result, by creating an integrated framework that considers the collective scale of investment, quantification of risks, and the long-term benefit to consumers these risks can be mitigated. This will ensure that at the time decisions are taken to invest, the financeability impact is known and have been sufficiently stress tested over these horizons. This will in essence create a structure that should ensure over time and avoid in period and between period regulatory and deliverability risks. The financial framework therefore must enable these decisions prior to the final investment decision and be reflective of the risk and overall network operator and not a subset of that operator. This includes considering the short, medium- and long-term horizons and a range of financeability stress testing scenarios.

#### Statutory Duty to ensure Financeability

The UK regulatory framework is seen as a leading framework around the world and any changes need to ensure they do not damage this reputation. Ofgem should ensure it considers financeability in line with its statutory duties and any changes to the regulatory framework must deliver the strong investment grade credit rating and market-based risk adjusted returns to equity investors.

The financeability assessment undertaken during price control reviews is a key pillar of the regulatory framework and it is our current view that it should remain a key cornerstone of setting a price control whether 8 years, 5 years or longer. As noted above, we would advocate for more robust stress and sensitivity testing of financial parameters as well as adapting to different archetypes where relevant. For example, whether future large investments under uncertainty mechanisms become similar to the TIRG arrangement within electricity transmission with separate financial arrangements or part of the core price control period or some other option. Even though we believe financeability should be subject to frequent reviews, the impact of regulatory framework decisions on financeability should be assessed over the short, medium and long term to ensure decisions being made in one price control do not have detrimental effects on the future. Within the any price control review or creation of a separate mechanism, financeability must be central to the decision-making process and not a side issue. The scale of investment, the need for acceleration, and the risk and complexity of investment make financeability even more a concern than would be the case for a more stable investment period.

The current assessment of financeability within price controls has however presented challenges. Ofgem has utilised notional company definitions at times which are inconsistent with reality, such as the use of Index Linked Debt (ILDs), low gearing ratios, and significantly large equity injections to mitigate credit rating downgrades alongside low-to-no dividend periods. Between these elements and current market conditions, credit financeability is a concern and Ofgem must ensure companies can secure the financing required to deliver Net Zero and ensure returns to investors are competitive globally on a risk adjusted basis.



We believe Ofgem should continue to undertake robust and plausible scenario analysis to stress test and ensure companies can continue to finance the necessary investment required to achieve the significant transformation in the energy system required over the coming years while addressing the large gaps currently seen between notional and actual company – taking cost of debt as an example. There is a need for calibration in the market movements in debt and it's been demonstrated that a flat trailing average doesn't reflect movement in rates. Trailing averages are not adaptive and therefore create an over/under funding in debt which have knock on effect with financeability.

We have seen the real time effects of this recently, demonstrating that when there are drastic changes in the external environment this leads to the sector being significantly under or over funded. Real life examples of this are interest rates in the current market and the supply chain demand needs demonstrate the need for additional reopeners throughout a price control to align changes in market conditions and developments. There is a case for us to rethink debt and how this is approached. Between the models we need to look at the benefit of being able to calibrate to new level of debt needed in the period which reopeners are needed as discussed in the previous section.

Market evidence over RIIO-2 process illustrate that the Cost of Equity has been set too low, and without action in setting the future price control, will cause a serious financeability concern.

Changes will likely be required to financial parameters beyond the cost of capital to support the investment necessary to deliver Net Zero. The level of investment growth moving forward in electricity distribution is a prime example of needing to consider long term financeability rather than short term bills and individual credit metrics as the litmus test.

Companies need to be looked at in their entirety to ensure they are financeable rather than looking at different mechanisms or investment programmes. This likely takes a risk around a disjointed, fragmented and potentially confused. The bigger overall picture needs to be taken into account alongside the long-term goals we are all aiming to achieve. For example, if there are times outside of the framework, such as large one off projects or programmes of investment that have to be agreed with Ofgem, then it should be clear whether this is a long term commitment or subject to a periodic review on returns. This emphasises the need for the financial framework to be reflective of risks and returns over the short, medium, and long-term horizons.

We note that there is a consultation being undertaken by UKRN to evaluate the approach to setting the Cost of Capital across regulatory sectors. We have seen inconsistencies being applied in PR19 and in RIIO-T2 and in particular we saw the CMA reach different decisions despite there being similar evidence in both price control appeals. We would encourage Ofgem to engage with the wider sector alongside UKRN to ensure this is tailored to suit sectors that are delivering a larger scale of investment and therefore have to attract the capital necessary to finance such investment. We would encourage Ofgem to move towards a more constructive approach to discussing the cost of capital and focusing on more than short term bill reductions. A critical part of providing a stable price control that accelerates investment and provides certainty is how the cost of capital is set, discussed, and mediated when required. We would encourage extensive engagement on this area since it is always the most contentious area within any price control.

#### Financeability impact on Consumers

Net Zero will not only play an essential role in addressing the climate crisis, but also in tackling energy security and affordability within the UK, which is vital to our consumers and stakeholders. The cost of living is a significant challenge in the UK, in the short term there are significant cost pressures, as shown by the headline rates of inflation, that will lead to bill increases for consumers. Beyond this, there is a need to recognise that the investment in network infrastructure will in the longer-term lead to significant bill savings for consumers.

In the electricity market, wholesale prices should fall as we transition to a decarbonised electricity system with home grown electricity generation and less reliance of expensive fossil fuel. It is paramount that moving forward Ofgem move away from focusing on short term bill impacts within price control periods and assess the impact of the wider picture over the longer term. Ofgem must recognise the value in attracting investment and the accelerating that investment will reduce consumer bills in the long term and moving forward through network investment being the critical enabler. As well as the price control being fair and balanced in its outcomes for consumers and investors it should also be as simple as possible for the consumer to understand.

Overall, the acceleration of network investment will significantly reduce consumer bills over time even when considering the steadily increasing share network costs make up within a typical consumer bill.

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

As a general comment, timings for analysis of options is very tight and Ofgem must ensure that a full impact assessment is required when introducing significant regulatory change, in line with its obligations.

The consumer interests framework contains some of the important points for any impact assessment to consider. However, there are several key aspects are not within this that must be considered to ensure that a full and proper impact assessment is carried out that looks beyond short-term bill impacts to the longer term benefits that investment in the network will bring. Specifically, under 'fair prices' and 'low-cost transition' there appears to be a clear focus on short-term impacts on consumers, with little or no reference to future consumers. We are also surprised that there is no reference to net zero within this framework as the ability for network operators to build infrastructure that will facilitate net zero must be a fundamental consideration for future price controls.