

Energy UK response to Ofgem's Consultation on Frameworks for Future Systems and Network Regulation

19 May 2023

About Energy UK

Energy UK is the trade association for the energy industry with over 100 members - from established FTSE 100 companies right through to new, growing suppliers, generators and service providers across energy, transport, heat and technology.

Our members deliver nearly 80% of the UK's power generation and over 95% of the energy supply for 28 million UK homes as well as businesses.

The sector invests £13bn annually and delivers nearly £30bn in gross value - on top of the nearly £100bn in economic activity through its supply chain and interaction with other sectors. The energy industry is key to delivering growth and plans to invest £100bn over the course of this decade in new energy sources.

The energy sector supports 700,000 jobs in every corner of the country. Energy UK plays a key role in ensuring we attract and retain a diverse workforce. In addition to our Young Energy Professionals Forum, which has over 2,000 members representing over 350 organisations, we are a founding member of TIDE, an industry-wide taskforce to tackle Inclusion and Diversity across energy.

Summary

Energy UK welcomes Ofgem's statement that recognises that there is a need for a change in networks of a scale not seen since privatisation. This is necessary to facilitate large-scale investment in electricity networks combined with potential decommissioning, and partial repurposing, of the gas networks. We agree that there is a need to ensure there is the right balance between building new assets, maintaining asset health and deploying smart flexible solutions. It is critical that the framework for future systems and network regulation can ensure that all consumers have reliable and robust networks.

Energy UK also welcomes the draft Strategy and Policy Statement for Energy published last week. This makes it clear that the FSO will be accountable and have responsibility for system planning across electricity and gas, along with the roles currently undertaken by the ESO. However, through various workstreams currently ongoing, the FSO's remit could include aspects of Distribution System Operation, heat, transport, hydrogen and carbon capture. Clarity on any further roles the FSO will undertake and by when is essential in developing the future regulation of networks.

Consultation Questions

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

It is critical that consumer voice is valued in any price control process, however, most consumers are likely to have little interest in the details. There are a number of bodies responsible for channelling consumer voice:

- Suppliers: consumers are able to make choices on their future usage of the network through their supplier. Suppliers compete for customers through their varying offerings. In turn, they can refine these offerings by influencing the price control process.
- Local Government and consumer groups: consumers have views on the nature of their electricity and gas networks, how they would like to buy their power and heat their homes, how much optionality they require and what that means in terms of resilience and cost savings. This could be channelled through local government and consumer groups.
- Ofgem: industrial and commercial connectees, across both electricity and gas, can be disinterested in the price control processes. Their focus is on connection capacity and consistency for their competitors across GB. Ofgem have a role in representing consumers in the price control processes, ensuring the networks work for consumers at a fair price.

The voice of other key stakeholders including developers and investors, and the channels through which it is engaged should also be considered. There will be an increasing number of parties interested in price controls as the whole system transitions to net zero.

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

A long-term, cross vector vision of the electricity and gas networks is vital in order to encourage investment in GB infrastructure. Increasingly, we have a clear view of what will need to be delivered by 2035 and 2050. Energy system plans should be developed with that vision in mind, including defining the required regulatory regime needed to achieve it. Energy UK welcomes National Grid’s ‘Delivering for 2035’ report, and particularly the proposal for a Strategic Spatial Energy Plan that will be owned by the government and have full weight in planning law.

A potential benefit of such a forward looking plan is that it would enable planning permission to be sought ahead of need for infrastructure projects. Establishing planning permission is relatively low cost and low regret, and if done in advance of investment decisions would de-risk projects, allowing a lower cost of capital. The plan would need to be sufficiently detailed and robust to be relied upon by investors and developers when seeking permissions. This could be used in conjunction with the Centralised Strategic Network Plan (CSNP), which will help to establish the future infrastructure need.

How detailed and effective such a plan could be is dependent on how quickly the FSO can be established, and how it is enabled for success. Future plans for electricity and gas infrastructure are intrinsically tied with the future of industrial hubs in GB, as well as major infrastructure such as new nuclear power stations and facilities for carbon capture and electrolysis. Many of these decisions can and should be made by government, in advance of the FSO being fully enabled across all vectors. This would then assist the FSO once it has been established and has acquired the necessary skills and capabilities.

As such, it's important that there is interim cross-vector planning using common pathways while the FSO is being developed and upskilled. Networks must be able to continue to develop infrastructure in the meantime.

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

It is vital that competition is only introduced where it can demonstrably add value either through a reduction in costs or timescales. Small, low-cost pieces of work are unlikely to benefit from competition. In addition, many of the same benefits could be delivered by clearer incentives on the networks. For example, if DNOs and TOs faced some costs for non-delivery, they might speed up connections. It is notable that where there are contestable works, the connecting party will usually do the contestable works themselves because it's cheaper and quicker. These clearer incentives could involve an element of ex-post monitoring, for example when customers experience significant slips of connection dates or poor communication from the network. It is welcome that such monitoring is included in the ASTI framework.

In order to benefit from competition, it is vital that there is a well-developed plan, which gives a clear specification that refines the scope of potential solutions. In the OFTO regime, unclear specifications mean that competition has led to a lack of consistency in developed products, which leads to issues with harmonisation.

The benefits from competition also depend on the timing of the competition within the network development process. We suggest that competition should be introduced after the specification for any infrastructure is clearly defined, in keeping with the forward looking plan defined in the answer to question 2, with building the asset competitively procured. This would enable accelerated delivery without degraded quality.

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

A simplified RPI-X could be a welcome option, as the current complex incentive regime requires a large amount of resource from both the networks and the regulator. Simple outputs could include 'DNOs must meet all connection times in X days', for example. It is important that any simplified incentives do not solely focus on the short-term lowest cost outcome. Whilst simplification could bring benefits, it would need to be distinct between DSOs and TOs.

It is also important that simplified regulation in some areas doesn't lead to less focus on others. In turn, this could lead to a piecemeal regulation approach that increases burden on Ofgem and licencees.

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

Energy UK sees limited benefit in an ex-post monitoring regime, as any ex-post penalties or disallowances could increase investment risk and therefore the cost of capital. For example, in the case of the St. Fergus Gas Terminal, National Grid made investments that were then disallowed by Ofgem, which damaged investor confidence.

Ofgem suggest that this could be an interim model in advance of a 'plan and deliver' model. Having 3 different models in a short space of time would be highly complex, and we urge caution with this approach.

Energy UK is also aware that Ofgem are trying to streamline ESO performance reviews, in part because it's difficult for them to manage. Introducing a similar regime across the three Transmission Owners would increase their workload further.

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

Energy UK suggests that for Electricity Transmission, there could be a greater role for government, as suggested in our response to question 2, with a more limited role for Ofgem in scrutinizing long-term plans. We believe that Ofgem should focus on ensuring timely and cost-efficient delivery of infrastructure.

The separation of each organisation's accountability and responsibility at each of the stages is not particularly clear. In our view, there could be a separation of box 1 into strategic and detailed planning, with different bodies involved. Strategic planning will be the responsibility of the FSO in conjunction with government, with technical input from the networks. This should also be where decisions are made *between* reinforcement and new build. These are presented as mutually exclusive on the diagram, but under many circumstances will be competing options. Detailed network planning should involve the FSO and the network licencees, who have expertise on their assets.

It is the strategic planning aspect that should facilitate anticipatory investment. Energy UK suggests that any change to price controls should be with the intention of delivering infrastructure more quickly; so strategic planning must be appropriately drawn out and valued.

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

We note the ongoing consultation on local institutions and governance which will have implications for the future of the distribution network. It is difficult to answer this question in the absence of that decision.

Some Energy UK Members disagree with the assertion that the future of the distribution networks is too uncertain for some aspects to be plan-and-deliver. Available information includes D-FES and EV rollout plans. It is also essential that the development of the distribution network is coordinated with the transmission network. It will be impossible to efficiently develop the transmission system without a view of the distribution network, so detailed planning across both systems is necessary.

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

There could be merit in moving to a simpler regulatory framework particularly for BAU activities if price controls are every 5 years or less.

Ofgem has excluded hydrogen infrastructure from this consultation, whilst noting business models are being developed for transportation and storage. In our view, the future of gas price controls will be intrinsically tied to the arrangements for hydrogen and they should be considered in parallel. For example, it is impossible to evaluate the level of repurposing of the existing gas network without a view on future hydrogen uses. At the very least, the next price control will need to consider how repurposed assets are accounted for in the gas price control and hydrogen regulatory framework, unless the two are merged.

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

There could be benefits to a 2 year rollover for the gas price controls, if significant policy decisions are made in the expected timescales, particularly the use of hydrogen for heat. On the other hand, this would seem contrary to the idea of whole system co-ordination. There would be a significant workload for Ofgem and the networks to implement a rollover in parallel with the RIIO-3 framework and business plan development. On balance, it is probably better to retain the current cycle and ensure frameworks are established to address major policy decisions when they arise.

In future, an independent whole-system planner with a clear, long-term whole system plan should mean that the exact timing of the price control cycles is less important.