

Email to:

FutureNetworkRegulation@ofgem.gov.uk

25 May 2023

Dear Gavin and Jane,

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

Scottish Renewables is the voice of Scotland's renewable energy industry. The sectors we represent deliver investment, jobs, and social benefits and reduce the carbon emissions which cause climate change. Our 330-plus members work across all renewable energy technologies, in Scotland, the UK, Europe, and around the world. In representing them, we aim to lead and inform the debate on how the growth of renewable energy can help sustainably heat and power Scotland's homes and businesses.

Scottish Renewables welcomes the opportunity to respond to Ofgem's consultation on the future of system and network regulation (FSNR). We strongly support the stated ambition to change regulation to fit the regulatory context that we now find ourselves in, i.e., the need for rapid, large buildout and investment in the grid to meet changing generation and increased demand and the need for the grid to be built in a manner that capacity is already in place to meet new demand. We are calling on Ofgem to follow through on this ambition in their ways of working and regulatory approach, while maintaining the need for well-regulated and efficient spend by network companies. We firmly believe that effective network regulation is a cornerstone to a cost-efficient and timely transition to Net-Zero and we are highly supportive of consideration of reform to ensure it is fit for purpose.

The Accelerating Strategic Transmission Investment (ASTI) programme has succeeded in providing Transmission Owners (TOs) with early certainty and funding, allowing them to procure earlier and more efficiently for in-scope projects. The new price control structure should reflect the principles of ASTI in enabling TOs to accelerate grid development.

We believe that Ofgem needs to update its legal remit to include Net-Zero in order to effectively support the rapid development of the grid ahead of demand and adapt its approach. We propose that Ofgem's primary duty be reformed to include Net-Zero as part of its principal duty – to protect current and future consumers whilst supporting an economically efficient transition to Net-Zero. This would give the regulator a strong statutory basis for achieving the aims set out in this consultation. At present, all the governments of the UK have Net-Zero targets. However, the

regulator of the energy sector does not, while it is acknowledged that it will do much of the heavy lifting to deliver Net-Zero. This mismatch of objectives cannot help but hinder a cost-effective and timely transition to Net-Zero overall.

It is also clear that beyond new regulatory frameworks, network companies would benefit from a new approach from Ofgem in terms of the “least regrets” attitude to network approvals. Changing the approach to a more ambitious view of network approvals will speed up grid buildout, help reduce the backlog of projects waiting to connect, give certainty to the supply chain, and most importantly, deliver on the decarbonisation and Net-Zero targets for the UK, alongside the economic and societal benefits associated with these achievements.

However, we do have some concerns with the current approach applied in the consultation. We would encourage Ofgem to set out a realistic timetable for regulatory reform as there is concern that there may be unintended consequences from pushing through significant change ahead of RIIO3. There is also a concern that this may reduce the incentive for TOs and Gas Distribution Networks (GDNs) to undertake stakeholder engagement now as this led to much higher quality plans in RIIO T2.

Another concern is that there are several regulatory reforms currently underway across Ofgem, Government, and National Grid ESO(i.e., work on DSO governance, charging arrangements, the Government’s review of economic regulation and ESO connections reform), and with all of these being considered 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. Whilst trying to resolve all of this at once aligns with the sense of urgency around Net-Zero, we suggest that an overarching strategy is needed to coordinate and ensure that changes are well-evidenced and aligned. We think there is a need to be careful of a ‘piecemeal’ approach to industry change that may lead to negative outcomes for consumers.

Finally, with the ambitious scope of work that is being left to the Future System Operator (FSO), given this organisation does not yet exist, it would seem a significant risk to assume that it will be ready to deliver challenging outputs from day one.

Scottish Renewables would be keen to engage further with this agenda and would be happy to discuss our response in more detail.

Yours sincerely,

Stephen McKellar

Stephen McKellar

Senior Policy Manager | Grid & Systems

Scottish Renewables

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

The role of the 'consumer voice' is crucial in the energy transition journey, especially as consumers are expected to play an increasingly active role in the energy system. As such, we view Ofgem's intent to increase the level and quality of their engagement following the RIIO-2 price control as a positive step in the right direction.

To support a just transition, it is essential to channel the consumer voice through appropriate institutions and processes that can effectively represent and communicate consumer views, especially more vulnerable consumers, to policymakers and industry stakeholders. It is also important that any enhanced engagement from Ofgem also includes grid users beyond consumers e.g., generators and providers of system services, as these users will be vital in achieving the decarbonisation aims set out in the consultation document. It should also be noted that the likely benefit of engagement is from understanding satisfaction levels and suggestions for change, not necessarily in the granular detail of how price control structures are designed.

The development by Ofgem of the enhanced engagement framework for RIIO seems to be of value for all parties. The User Group for transmission companies and the Customer engagement group for Distribution is an appropriate reflection of the interest and ability of third parties to inform the regulatory settlements. The complementary role of the Challenge Group adds weight to the influence of these groups.

A downside seems to have been the extent to which Ofgem has listened to and acted upon the feedback and reporting of these groups in the final settlement process. Ofgem should look to improve this in any future regulatory framework, noting that all these groups are focused on the outcomes and outputs that the network companies deliver rather than the complexities of how a funding mechanism should be constructed.

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

An independent, cross-vector view could provide valuable insights to determine future plans for periods beyond RIIO-2 and support the effective use of the 'Plan and Deliver' model. However, it is important to note that this would be a significant undertaking and the rapid increase in grid buildout needs to start now, so any changes must not cause delays in and of themselves.

Any change to the modelling approach and centralised planning must accompany a change to the "least regrets" approach to network development to ensure that the grid is built in a way that will deliver on 2030, 2035, and ultimately 2050 Net-Zero targets. This change in ways of working would be well demonstrated by a change in remit, to include Net-Zero, which would give a clear signal and reason for strategic grid buildout.

We see benefits in aligned regulatory frameworks between the ESO and TOs to ensure they have the same objectives informed by a whole system perspective. Closer alignment in regulatory objectives will prevent the ESO and TOs prioritising different goals or measuring success in different ways, which can lead to friction.

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

The current methods of procurement are not delivering the required grid infrastructure and are a potential barrier to meeting decarbonisation targets. Therefore, Ofgem should be cautious to base future regulatory frameworks on existing procurement practices.

Competition, or other procurement models such as open book contracting, may have benefits over ex-ante incentives as a cost control mechanism, provided there are sufficient competitors to ensure competitive pressure exists. However, within the context of the current global supply chain squeeze, it is not clear that the required competitive pressure will be present to make a competition model effective in providing cost efficiencies. We note that in this context, the Dutch-German TSO TenneT has dropped the traditional single tender approach in favour of much larger 'cooperation agreements' to supply large amounts of equipment.

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?

The RIIO framework introduced a range of incentive regulation which has broadened the output of TOs to meet consumer and stakeholder needs. Customer, and stakeholder satisfaction and timely connection incentives have improved the experience of dealing with network companies, driven collaboration, and consistency, and achieved tangible outcomes such as earlier connection dates and increased customer satisfaction. However, much more must be done in all these areas, therefore, retaining and strengthening appropriate regulatory incentives must be incorporated into the future regulatory framework.

Some operations carried out by regulated network companies may be suited to simpler regulation than in RIIO-2, however, there must still be clear minimum standards for delivery, which may not be the same as the short-term lowest-cost outcome. Simplification of incentive regulation must be cautious not to result in perverse incentives to reduce costs at the expense of performance. Incentives related to customer and stakeholder satisfaction and timely delivery in particular have the potential to ensure high-quality service.

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?

Ex-post monitoring may work in some circumstances, but the timescales must be more regular than a standard 5-year price control period. In ex-post monitoring, there must be incentives to change behaviours as soon as shortcomings are found. This regime may allow for longer-term planning of a net zero network as a demonstration of short-term or immediate need is not required. However, this may also require longer-term monitoring beyond that of the price control.

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

The consideration of new approaches to regulation focused on delivering new infrastructure at pace is welcome. However, Ofgem must approach any changes cautiously as implementing a step change in regulation may create uncertainty and deter investment. RIIO has achieved positive outcomes in supporting the transition to a low-carbon electricity sector and an evolution building on this foundation appears a lower-risk approach to achieving 2030 targets.

We encourage Ofgem to be mindful of any barriers identified and careful to ensure that barriers to the implementation of new price control structures do not become causes of delay in and of themselves. It is vital that any change in approach keeps the current pressing need for the increased buildout of grid infrastructure and does not provide a long-term solution but a short-term barrier.

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?

- N/A

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?

- N/A

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

Ofgem should be cognisant of the opportunity cost of rolling over these controls if it chooses to do so. Rolling over the fourth transmission price control review was a complex task and the RIIO price controls are more complex than those which came below. Rolling over RIIO-2 for two years may take resources away from developing the price control framework or other issues of concern such as connections reform.

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

- N/A

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

Networks are at the heart of facilitating the efficient delivery of domestic clean renewable energy to end consumers, and this requires an exceptional scale and rate of change. We are therefore aligned with Ofgem's view that the scale of activity and pace of progress required to meet these targets necessitates a change in how network investments are delivered and the frameworks under which they are governed.

Analysis of the best outcomes of regulation must be focussed on the delivery of a cost-efficient delivery of Net-Zero. Previous network regulation has been highly focussed on cost minimisation but with little focus on the timely delivery of decarbonisation of the system. This must be central to the assessment of the suitability of any future regime of network regulation.

Missing from the consultation is due consideration of Ofgem's role in the network regulation – in particular Ofgem's remit. Ofgem's remit must be reformed to ensure a strategic approach to grid development is taken.

The heavily delayed Strategy and Policy Statement (SPS), intended to guide Ofgem's approach to policymaking has recently been published. However, it is not clear that it will have sufficient legal strength to guide Ofgem's behaviour appropriately. Therefore, foundational to ensuring necessary and timely network investment lies in both a very strong SPS focused on the delivery of low carbon GWs and achieving an economically efficient net zero, and subsequent reform of Ofgem's legal remit.

Ofgem's primary duty should be reformed to include Net-Zero as part of its principal duty – E.g. To protect current and future consumers whilst supporting an economically efficient transition to Net-Zero. The inclusion of Net-Zero in Ofgem's remit is supported by the National Infrastructure Commission, The House of Lords Industry and Regulators Committee, and The Skidmore Review.