

Jane Dennett-Thorpe & Gavin Knott  
Ofgem  
10 South Colonnade,  
Canary Wharf  
London  
E14 4PU  
[FutureNetworkRegulation@Ofgem.gov.uk](mailto:FutureNetworkRegulation@Ofgem.gov.uk)

**Wales & West House**  
Spooners Close,  
Celtic Springs, Coedkernew  
Newport NP10 8FZ

**Ty Wales & West**  
Clos Spooner,  
Celtic Springs, Coedcernyw  
Casnewydd NP10 8FZ

19<sup>th</sup> May 2023

## **Wales & West Utilities Limited (WWU) response to ‘Consultation on frameworks for future systems and network regulation: enabling an energy system for the future’**

Thank you for the opportunity to respond to the above consultation. We welcome the input and provide an exec summary on our views below. The detailed questions we respond to from page 3 onwards.

We support the need to deliver net zero and the need to ensure the regulatory regime across energy companies is fit for purpose to encourage investment and protect consumers.

Given the level of uncertainty about how and what needs to be delivered to achieve net zero the regulatory framework must provide agility and ability to support whole system decision making. This will also ensure that while we wait for the outcome of several policy decisions, we are able to still respond to change and not delay progress.

The framework must ensure the networks are incentivised to play a key role in delivering net zero and delivering benefits for today's and future consumers. The long-term planning for the energy system is vital to ensure we invest efficiently and to maintain resilience while the transition continues.

Whilst we welcome the open consultation on different regulatory regimes there is no strong case to make radical changes at this time. Consumers have benefitted from the RIIO regime to date, and it has evolved to address the changing needs of the industry. However, we can always improve the regime and enable it to react to changes to other external factors that are influencing the framework required for example: -

- Regulatory burden must be reduced to reduce costs for consumers and free up resources to focus on delivery.
- Incentivisation has reduced through the RIIO regime, we must see further incentivisation for delivery which has benefitted consumers.
- Consideration of longer-term benefits to customers should be incorporated into regulatory decision making to ensure short term benefits do not contradict future needs.

### **Wales & West Utilities Limited**

Registered Office/Swyddfa Gofrestredig: Wales & West House, Spooners Close, Celtic Springs, Coedkernew, Newport NP10 8FZ.  
Registered in England and Wales number 5046791



Smell gas? Call us free on  
Aroglu Nwy? Foniwch Ni Am Ddim

**0800 111 999\***

\* All calls will be recorded and may be monitored. For information on our privacy policy see: [www.utilities.co.uk/legal](http://www.utilities.co.uk/legal)  
\* Caiff pob galwad ffôn ei gofnodi ac efallai'i fonitro. I gael gwybodaeth am ein polisi preifatrwydd, gweler: [www.utilities.co.uk/legal](http://www.utilities.co.uk/legal)



0800 912 2999



[enquiries@wwutilities.co.uk](mailto:enquiries@wwutilities.co.uk)



[www.utilities.co.uk](http://www.utilities.co.uk)



[wwutilities](https://www.facebook.com/wwutilities)



[@wwutilities](https://twitter.com/wwutilities)



[@wwutilities](https://www.instagram.com/wwutilities)

- The regime should ensure it attracts investors with a competitive return, commensurate to risk, to deliver value for consumers which will become critical when significant new infrastructure is required.

The different regulatory regimes proposed all have their role and could all work in a mixture of different scenarios as they do today. Utilising the advantages of each archetype under the correct activities to deliver the most appropriate outcome for consumers is vital.

- Archetype 1 'Plan and deliver' will ensure the right outcomes for regional and national planning but competition and direct award could be better utilised by the network companies however the level of market maturity has some way to go before this can be implemented.
- Archetype 2 'Ex ante Incentive Regulation' should remain key in under pinning the regulatory regime given the benefits delivered in the last decade, whilst returning to the higher levels of incentivisation seen in RIIO1. Even more critical.
- Archetype 3 'Freedom and Accountability' can deliver 'at pace' more uncertain activities providing the post review framework is clear and the cost of capital reflects the higher risk in their scenario.

Consequently, we understand the need to explore a roll-over of RIIO 2 given the level of uncertainty and policy decisions ahead. We are concerned if an alignment was inevitable post a 'roll over' then we need to ensure a robust and qualitative process is carried out for the gas distribution networks. The consideration of the resourcing costs for consumers of alignment needs to be explored to ensure it is efficient.

We would need to ensure a 'roll over' was incentivised appropriately and offers the simplification to allow networks to continue to deliver for consumers.

In summary, we need to design a regulatory regime that's able to adapt and not slow down the pace of change needed to deliver net zero.

This response is not confidential.



Sarah Williams

**Director of Regulation, Asset Strategy, & HSE  
Wales & West Utilities**

## Our responses to the Consultation Questions

Below we have laid out our views in response to each of the questions included in your [Consultation on frameworks for future systems and network regulation: enabling an energy system for the future](#)

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

The consumer voice is fundamental to the future of the regulatory framework, after all we are providing an essential service to the consumer. We need to carefully balance the wants and needs of our consumers, considering the GB net zero targets and potential future energy supplies. Noting that c.85% of households in the GB use gas to heat their homes, consumer choice is going to be important as we transition to net zero.

The consumer voice needs to be focused on regional requirements given the Future System Operator (FSO), the Regional System Planners (RSPs) and plans for industry, transport, storage, and uncertainty on heat policy.

Consumer or 'Stakeholder engagement' will need to be across a larger demographic than ever before from domestic and business customers to industrial users as well as local authorities and regional governments. Potentially there is large change coming for consumers and a coordinated approach will be required at a national level with support from local authorities to educate consumers on the need for change. A clear line as to where this engagement should lie needs to be agreed, the division of obligations between the government, the FSO and network companies will have to be considered carefully.

Significant work was completed in GD2 to ensure the consumer voice was incorporated into business plans but disappointingly, this was given little weight in the outcome of Ofgem's settlement. It is important that Ofgem sets out a clear expectation for networks at the outset demonstrating how consumer views will be evaluated to support the final price control settlement.

The consumer engagement groups (CEG) and Ofgem's consumer challenge group (CCG) will have a crucial role in future controls and there is a need to ensure they have clear responsibilities and influence where necessary to support the UK's policy and planning. Additionally, there is a need to ensure a level of consistency between the regional CEGs to deliver a level playing field when evaluating customer engagement between networks but still recognising regional variances to consumer needs.

There is a need for Ofgem to be clear on the quality expectations of acceptable stakeholder engagement and its use in the settlement process. Ensuring and incentivising, where appropriate, joint national work to reduce costs for the sector and ultimately reduce costs for consumers. Additionally, directing engagement through institutions that can align views and provide valuable insight (e.g., citizens advice, local authorities, energy councils and industry organisations etc.).

**Q2 - How detailed could an independent, cross vector view become to determine future plans for periods beyond RIIO-2 and support effective use of the 'Plan and Deliver' model?**

We agree an independent cross vector view is the right outcome for the UK's energy needs. But the inclusion of regional planning is key to ensuring this works across whole systems and consider all consumers.

The FSO and RSPs need to be established early and have clear roles and plans for the long term to support an effective 'Plan and deliver' model. Ensuring there is expertise for all parts of the energy system is vital across transmission and distribution for both Gas and electricity.

Consideration of the consumer voice across regions will be the most important driver of planning decisions and a process of how these are input will need to be considered as part of the RSPs remit.

Significant input by all transmission and distribution companies will be crucial to ensure detailed plans are achievable and engineering solutions are effective and appropriate. Incentivisation for companies will be required to ensure all are working to the common whole systems agenda and to produce long term plans.

The 'Plan and deliver' model which focusses on strategic needs does not need to be coupled with competitive delivery of an identified solution as per your model example. The solutions could be delivered using archetype 2 or 3 by the experienced companies and incentivised appropriately to ensure it is delivered effectively for consumers. This would drive quicker progression and utilise skilled resources already trained in the utility industry. Our concern is if we have a delay or under utilisation, we may lose skilled resources and struggle to recruit without significant cost and delay to commencing work. We cannot have a delay in workloads and workforce utilisation while institutions are set up.

The 'Plan and deliver' model currently has not been used at any scale onshore and is assuming a large supply chain exists, who are willing to compete for new and uncertain work. This is untested and could increase the risk of timely and cost-effective delivery at a time when infrastructure investment is crucial to delivering worldwide net zero targets.

Consideration needs to be given to where and how the obligations then get handed to the licensee on completion of 'competitive' work as well as the treatment of RAV under this regime. Consumer fairness on who pays for this across the energy consumers and socialisation of costs would also need to be considered in a different way to archetype 2 and 3 unless the energy companies are carrying out the work using the current models.

**Q3 - Under what circumstances would competition, or other procurement models such as open book contracting, have benefits over ex ante incentives as a cost control mechanism?**

We agree with the textbook economic benefits of competition, but this does not consider the real practicalities of this model. The nature of this work is new and uncertain so having appropriately skilled resources, (we as GDNs currently struggle to recruit) outside of the networks to enable different activities to be carried out is unknown. How risk is factored into contracts could be highly variable and can result in compensation events part way through a large-scale project or a 'Winner's curse'. Quality and non-delivery implications would also have to be managed by an entity.

Competition can positively encourage and stimulate innovation in the industry but currently we have an effective proxy for competition within the energy regulatory regime which delivers significant savings for consumers.

Additionally, there will be a missed opportunity to utilise skilled resources already in the gas industry to cross flex during unproductive or seasonal changes in workload – this is how we deliver best value for consumers today rather than having stranded resources during the summer months, for example when reported gas escapes are typically lower.

We have used open book contracting in our industry for several years successfully. The option under archetype 1 for direct award by the licensee could be more suitable as the licensee would be utilising back-office management resources, internal skills and reducing risks as mentioned above. Our experience of this has included a pain gain approach delivering saving for consumers but currently our internal delivery model is more efficient and delivering value for consumers.

**Q4 - What is your view on the options identified for simplification of incentive regulation? What would be the benefits and costs by comparison to the approaches used in RIIO-2?**

We support efforts to bring about greater simplification of the regulatory process and note that certain aspects of recent price controls have proved unnecessarily burdensome while adding little value for customers. Simplification was a core principle of RIIO 2 however, this was not delivered with RIIO-GD2 being more complex and burdensome than RIIO-GD1.

We agree with Ofgem on 'demonstrable and enduring step change reduction in regulatory burden' for the next price control process, coupled with more focused and timely customer reporting and consideration of the wider stakeholder value that networks deliver.

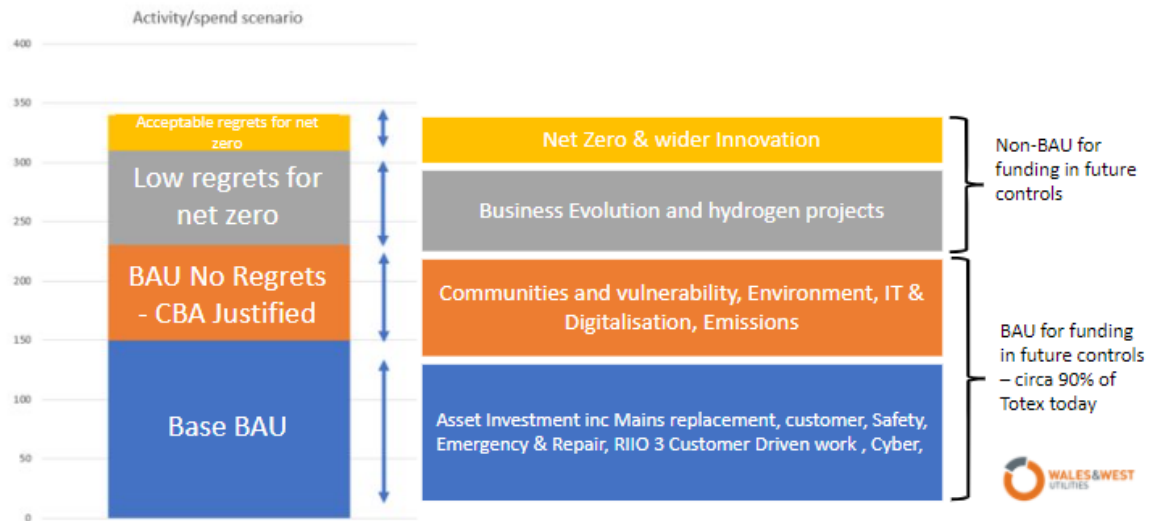
Principally we could use this simplification approach to apply to 90% of our cost base, utilising it for business-as-usual activities and longer-term allowances for areas of certainty<sup>1</sup>. Diagram 1 over provides the types of work and the cost stack we envisage to be included in a simplified approach.

---

<sup>1</sup> Our open letter response in October 2022 detailed the principles of our approach.

Diagram 1

## Totex Cost Stack – Work Types



This approach to the cost stack would allow Ofgem to focus more on the uncertain aspects of the price controls.

Some examples of simplification of a future RIIO control could include.

- Setting known repetitive work on an ex-ante approach over a longer period to reduce administration on a shorter periodic basis – even basing these on mechanistic revenue drivers where appropriate.
- Lighter touch on outputs focusing on high level primary outcomes to reduce burden of licence amends and detailed reporting.
- Simplification of uncertainty mechanisms and clear evidence guidelines could reduce resource burden for Ofgem and the networks including speeding up delivery of the work required [whilst reducing costs].
- Greater use of 'use it or lose it' allowances for areas of no regrets work with positive outcomes for consumers.

In general, we also need to ensure the process of setting a price control is done in a timely manner with clear planning. Policies and mechanisms need to be understood in advance of a business plan submission and to ensure there are no inconsistencies in scenarios or submissions which could make assessment difficult.



**Q5 - What are the network activities where there would be benefits for a move to an ex-post monitoring regime, and what would be the associated costs?**

An ex-post monitoring regime principally would allow companies the freedom to deliver efficiently and within an appropriate timescale suited to skills and planning needs it would need to cover the correct activities and have a well-defined framework which companies and consumers understand.

The ex-post productivity cost assessment mechanisms would only work for repeatable comparable known workloads and only if incentives were in place to balance the risk of post allowance penalty. There would need to be a clear framework for the cost assessment and penalty process in place up front to ensure we understand the potential outcomes. In terms of risk, an ex-post approach would also decrease the collaboration and incentivisation to share innovation and efficiency activities across the energy companies and would also require compensation through cost of capital allowances to balance the risk.

The type of activities that would suit this approach would be asset investment costs replacing and refurbishing of assets which is circa £50m - £70m<sup>2</sup> per annum for WWU. This would allow us to be more agile with assets that are found to be in a poor condition or in need of a health improvement mid-price control which would have previously not been included in workloads, costs, or outputs.

Innovative solutions identified during a control would also be utilised and provide value for money for consumers in this example and a post review would demonstrate efficiency and potentially be treated on the basis of a price control deliverable – incentivising networks to push for further innovation.

Potentially the work required under the ‘future of energy’/uncertainty remit could be utilised in this example with an ex-post review of costs given the unknown nature at the time of the price control settlement.

Additionally, the unknown regulatory burden of a ‘close out’ review at the end of the control could push the cost base up for both the regulator and company.

**Q6 - What are the benefits and costs of this approach for Electricity Transmission by comparison to an evolution of the approach in RIIO-2, and what are the implementation barriers?**

No response from WWU

**Q7 - What is the potential for Electricity Distribution planning and commissioning to move to an alternative model by the end of RIIO-2, and what might be the benefits and costs of doing so?**

No response from WWU

---

<sup>2</sup> Assumed 18/19 prices.

**Q8 - 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?**

Whilst there is considerable uncertainty about how net zero will be delivered, [and what that will mean for regulated energy networks] the future regulatory framework must allow progress towards these key aims in spite of this uncertainty. It is essential that the framework allows low regrets expenditure to ensure we are (i) not building up a backlog of infrastructure investment that not only will cost consumers more but would also risk its deliverability over a shorter time frame and (ii) exploring different potential solutions to net zero, such that the ultimate path is well considered, effective and low cost.

The regime needs to support the delivery of net zero and energy independence for the UK and should include the following.

- Certainty to support continued investment to deliver safe & reliable assets.
- Flexibility to support a change in policy direction if needed.
- Consumer voice considered and a clear framework for use.
- Clear framework and guidance for all archetypes
- Investor attractiveness to provide the capital that will be needed.
- Economic benefits for local economies and skills
- Least cost and best value for consumers over the long term
- Incentivisation for companies to provide best value for consumers.
- Simplification and reduction in the regulatory burden

We cover the benefits of simplification in question Q4 above which highlights some examples of simplification but principally we would expect to gain the following benefits.

- Less onerous cost assessment process for operating and compliance activities as these are consistent and repeatable reducing external resourcing as part of price control planning and assessment.
- We mention longer term allowance setting in question Q4 – these activities could be used under this approach, again reducing the effort of Ofgem over short term price control periods.
- Lighter touch on outputs reduces reporting requirements and frequent licence amendments.

These benefits in theory should allow Ofgem and networks to focus on areas of uncertainty and delivery of workload efficiently.



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

We recognise that the planned 2026 decision on hydrogen for heating will not be available in time to meaningfully inform discussions for any price control that commences in 2026. However, regardless of the hydrogen decision, the majority of activities that GDNs will undertake during the next price control period will be the same activities that are being undertaken today.

When considering whether to roll forward the current GD price control it is necessary to think very carefully about what aspects could and should be carried forward. A lot has changed since the business plans for the RIIO-GD2 period were submitted including Brexit, covid pandemic, cost of living crisis, hydrogen policy evolution. While it might be possible to “roll forward” some aspects of GD2 plan, other aspects cannot be rolled forward as they reflect bespoke, annual plans or they are based on assumptions that are increasingly out of date – these would need to be revisited.

Any extension of GD2 would only be appropriate if it is carried out in a light touch way, otherwise it risks being hugely burdensome, costly for customers and not actually creating any more certainty. It must also be undertaken in a way that is fair for both customers and investors. Given how long it necessarily takes to set a full price control, we also need to avoid the prospect of having to resource two concurrent sets of price control discussions – but based on differing sets of assumptions and policies for different time periods.

We are conscious that we are being timed out of a full price control process given the summer consultation and workshops which will impact on the quality of submitted business plans if the original 2026 timescales were adhered to.

The approach for a roll over should follow the principles of incentivisation for companies given the CMA appeals across GD and GT and a simplification of outputs and cost assessment.

The other concern is the alignment with electricity distribution price controls if a proposed roll over is carried out for 2 years – have Ofgem considered the burden and effort in multiple business plans and license updates and the stranded resources that will exist between price controls? Is this in consumers best interest?

**Q10 - Would there need to be any changes to maintain a stable and consistent financial framework if we were to make greater use of different regulatory archetypes, and if so, what would those changes need to be?**

The analysis and consideration of networks' financeability for RIIO-2 price controls was assessed very narrowly, with little consideration of the longer-term impact of Ofgem's decisions on companies' abilities to maintain appropriate credit ratings and raise capital.

It is not sustainable to expect networks to be able to raise new capital in circumstances where key ratios cannot be consistently met or where it is assumed that dividends cannot be paid. This is simply not going to be sufficient to compete internationally for finance.

The assessment of financeability must change to consider financeability over both the short and long term and from the perspective of both debt and equity investors. With the focus on the international markets within which debt and equity operate. If better and more certain returns can be achieved outside of the regulated UK energy networks, then obtaining future investment will be challenging and more expensive than it otherwise needs to be. This is particularly important at a time when investment by networks is expected to increase significantly to meet the Government's target of net zero by 2050.

Similarly, financing decisions that consider how costs will be funded over time, such as capitalisation and depreciation assumptions, need to be made with longer term prices, inter-generational fairness, and wider societal impacts in mind, rather than through the narrower lens of immediate prices or immediate financeability ratios for the immediately upcoming control only. The cumulative effect of decisions that move even small proportions of cost into later price control periods will have considerable impact on future bills, at a time when increasing investment will also place upward pressure on bills.

The introduction of significant ex-post regulation in the suggested archetypes and related confirmation of Totex allowances only after the end of the control period increases uncertainty for regulated businesses and their debt and equity investors. This increased uncertainty will require compensating in order to ensure continued appropriate investment on a timely basis. This at a time when there is significant uncertainty over the UK government's intended direction of travel for future energy, transport and heat strategies, also increasing risk to inward investment in fossil fuels generally and the gas sector in particular.

Ex-ante regulation offers a lower level of uncertainty to investors once the control has been appropriately set. In a time when Government policy isn't sufficiently clear, and there is specific uncertainty in gas, a two-year extension to RIIO-GD2, if set appropriately to address the insufficient allowances in RIIO-GD2 and to cover the efficient costs of operating and developing those networks, to allow development of that Government policy, would be an appropriate approach. We do though question whether such an extension should be longer, to enable appropriate time to digest newly published Government policy and develop appropriate approaches to network and energy security for the next full control period.

In such a period of significant change, it is inevitable that some spend will occur on alternatives which are not ultimately found to be viable or efficient. However, allowance for such spend needs to be made in order that the best solution is delivered. This will result in no regret spend and an acceptable level of regret spend should be allowed within the allowances to ensure that longer term the least cost solution is achieved.

The financial framework must meet the needs of both debt and equity investors in the short and longer term. It must consider the whole licensee, and not just specific individual components that may be amended from time to time.

Transparency, predictability, and longevity of approach across price controls by Ofgem is important to ensure that the right amount of capital is available to the networks at the time they require it and at an efficient cost.

#### **Q11 - Do you have any views on our proposed analytical approach?**

This consultation raises fundamental change to the current regulatory framework and the proposed impact assessment should consider a robust and thorough approach.

The impact assessment must include.

- Long- and short-term impacts of regulatory framework decisions.
- The impact of not factoring in the cost of delivering net zero.
- The consumer impacts of regime decisions.
- Consideration of attracting competitive capital and investors
- The whole system decisions and the impact this will have on current and future bill payers.

We support assessing the regulatory framework options against a counterfactual but should consider RIIO 1 along with RIIO 2 as suggested, RIIO 1 provided a lighter touch approach to regulation and longer-term outputs and incentives which will be helpful when considering incremental change.

In general, we would expect Ofgem to be clear in justification of decisions reached and ensure they are underpinned by long term consumer interests.