

Sector Specific Methodology Consultation response

Appendix 3: Response to ET Annex

March 2024



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1 Introduction

In this annex we set out our response to the questions in the Electricity Transmission (ET) annex of the Sector Specific Methodology Consultation (SSMC) for RIIO-3.

We have responded to the questions by exception as we have a legitimate interest in the development of RIIO-3 as our customers, stakeholders and shareholders could be significantly affected by the outcomes of this consultation. Where we have not responded to a question set out in the consultation, we have not included that question in this response document. We have not responded to questions where we have no direct comments to make or where the question is very specific to the sector in question.

Our response documents should be read cognisant of our key matters set out in our covering letter. The five key matters most important to Electricity North West, which have the biggest effect on our consumers are:

1. Undertaking separate, unfettered consideration of RIIO-ED3 is essential to enable electrification to achieve Net Zero;
2. Maintaining the stability of core regulatory principles in the face of significant change;
3. Ensuring that each sector has a financeable and investable framework calibrated to the requirements of that sector;
4. Protecting consumer interests by incentivising the behaviours consumers prioritise at the levels at which consumers value them; and,
5. Accelerating the levels of innovation and digitisation that will improve the affordability of delivering the Net Zero transition.

It is in this context that our response is limited to the development of RIIO-3 for Gas Transmission, Gas Distribution and Electricity Transmission only. We look forward to the process beginning for the RIIO-ED3 price control in a few months' time on an unfettered basis.

2 Delivery of major new projects

Question 1: What are your views on the materiality threshold that should be set to determine which projects fall into or out of our proposed major projects regime?

We support the overall aims of a streamlined process for major projects and agree that a financial threshold is appropriate to have in force to distinguish what falls under this regime and what has an alternative regulatory treatment. However, there is insufficient information in the consultation as to how the sub-£100m projects will be treated to be able to comment conclusively on what an appropriate financial threshold for the major projects regime should be.

Whilst we recognise, and agree, that there is a justification for different regulatory treatments depending on the size of a project, and the assessment regime it has gone through, stakeholders need to understand the detail of the two different regimes to be able to provide fully informed views.

Whilst Ofgem refer to the major projects regime as a streamlined regulatory process, the steps described do not mean reduced scrutiny, in fact the opposite is true, given the steps within the Centralised Strategic Network Plan (CSNP), the role of the Independent Technical Assessor (ITA), the Ofgem assessment scrutiny and the subsequent delivery obligations which all mean that the major projects regime is likely to be a detailed and onerous process. Any financial materiality threshold

level should be set with this in mind, ensuring a proportionate approach to each of the regulatory regimes, mindful of the importance of pace which is clearly understood by all stakeholders.

Question 2: What are your views on our proposed approach to setting PCF and ECF, the scope of PCF and ECF and continuing the 'operational aspects' introduced under ASTI?

We agree that PCF and ECF are crucial components of the regulatory framework and an element of up-front funding is necessary to ensure supply chains can be stood up and the required preliminary work can proceed unhindered by regulatory funding delays or uncertainty.

Given the Accelerated Strategic Transmission Investment (ASTI) framework is a relatively new regime, it is unclear how well this component is currently operating and therefore what, if any, changes could or should be implemented.

In any event, ex-ante guidance on the application of this funding and eligibility of costs should be sufficiently clear to avoid any disallowance risk that could have unintended consequences.

Question 3: What are your views on options for how the ITA could be implemented for major new ET3 investments, and what are your views on its role and scope?

We agree it is important that any streamlined regulatory funding process for such significant levels of expenditure should have built-in protections to ensure efficiency and consumer interests are protected. How this is best achieved and whether the ITA is the right method for doing this is one for Transmission Operators (TOs) to better comment on based on their experience to date.

Question 4: What are your views on introducing a delivery incentive into RIIO-ET3 for major projects that is broadly similar to the ASTI ODI-F? Do you consider that delivery should be more strongly incentivised than under ASTI, and if so how?

As we reference in our response to question ETQ2, the ASTI regime is still relatively new, and therefore it is not yet observable how the delivery incentive package is working and how effective it is.

Financial incentivisation is a key pillar of RIIO and the regulatory framework. In principle it is also the best tool to reward on time delivery.

For RIIO-3 it is unnecessary to have both Price Control Deliverables (PCDs) and ODI-F in place. Recognising the change for RIIO-ET3 with the use of the CSNP to validate network need and solution, there is less justification to have a PCD in place as the solution has already been defined, and it is on-time delivery that is of the most importance to consumers and stakeholders.

The package put in place to ensure timely and efficient delivery should be designed to drive outcomes for consumers and be proportionate without introducing unnecessary complexity. It should also allow for milestones to be adjusted where justified and in consumer's interest.

Question 5: What are our views on our proposed cost assessment approach for major new RIIO-ET3 projects?

The cost assessment process for major projects is specific to ET and therefore we have limited comments and views as its applicability to Electricity Distribution (ED) is limited.

We would comment that as with ED, the calibration of Totex Incentive Mechanism (TIM) and cost sharing rates are important to ensure that networks are incentivised to deliver efficiently for consumers. We would advocate that TIM is strengthened in RIIO-3 and in RIIO-ED3 to encourage innovation and efficient delivery in a period of significant investment to decarbonise the network and enable Net Zero policy goals.

Additionally, we support measures that speed up and unblock barriers to delivery of strategic investment or major projects on the transmission network. It is important that Ofgem safeguard that distribution works related to these schemes are also supported in a way that ensures agile decision making to safeguard that these works do not become a blocker to timely delivery for consumers. We have experience of the challenges and issues that occur due to differing regulatory frameworks in RIIO-2/ RIIO-ED2 regarding the network investment project at Harker. We note that close working between ourselves, Ofgem, and National Grid Electricity Transmission (NGET) is progressing the project though consideration upfront ahead of the price control period can avoid the need for agile in-period decision making to overcome framework issues.

Question 6: What are your views on our proposed treatment of sub-£100m schemes identified by the CSNP?

The consultation contains limited information as to how the sub-£100m projects will be managed within the regulatory framework for RIIO-3, meaning it is difficult to respond fully to this question and to question ETQ1 on whether the financial threshold of £100m is the most appropriate.

We agree with the principle that the characteristics (as set out in the consultation) used for the major projects regimes should also apply to the sub-£100m projects as, whilst smaller, they are still significant projects and expenditure and the focus on pace of delivery and need for improved regulatory approval remain equally relevant.

We note that the future of Medium Sized Investment Project (MSIP) mechanism is under review and is linked to the decisions made in this area. However, it is important that all projects have appropriate level of scrutiny to protect consumers interests, whilst maintaining the principle of streamlined regulatory processes. The decision process should not unduly delay projects though we understand that the Ofgem capacity to review and make robust decisions in a streamlined way is subject to Ofgem having the relevant information provided to it by the companies in a timely manner. There is a risk that a two-tier approach has unintended consequences. What is of utmost importance is that the regulatory funding approval timeline, as well as the mechanisms to hold companies to account for delivery, are designed in such a way that are:

- proportionate to size,
- work within timescales that are synchronised with the TO's delivery, and
- reflect the timescales relating to the consumer needs for the project to be delivered.

This can then give companies confidence and the ability to proceed unhindered by regulatory approval regimes whilst still ensuring appropriate consumer protections are in-built.

Further we note paragraph 2.59. Whilst we don't have a view of the best way to address the approach to cost assessment for sub-£100m projects, we support measures that speed up and unblock barriers to the delivery of strategic investment or major projects on the transmission network. It is important that Ofgem safeguard that distribution works related to these schemes are also supported in a way that ensures agile decision making so that these don't become a blocker to delivery for consumers.

3 Load related expenditure outside of the CSNP

Question 7: What are your views on our proposal for load-related expenditure outside of the CSNP, how these mechanisms can be improved and streamlined, and the appropriate thresholds for the mechanisms?

We welcome the Ofgem decision to retain local level planning with the TOs outside of the CSNP, recognising their legal and safety obligations. Local planning, and the examples provided in paragraph 2.61 of the consultation, are critically important to connecting customers, both at the transmission and the distribution network level. Therefore the efficient funding of this work is rightly recognised by Ofgem as a key component of the regulatory framework for RIIO-3.

We further agree with the Ofgem principles and decision flow chart in figure 2 of the consultation document, whereby certainty is funded through ex-ante allowances, whilst uncertain needs or costs are dealt with via re-opener or other appropriate uncertainty mechanisms (UMs).

We do call for the re-opener mechanism and process to be reviewed and streamlined. Our observations with RIIO-T2 Large Onshore Transmission Investment (LOTI) and MSIP re-openers, is that these are often lengthy regulatory processes, which may not be aligned with the pace and urgency we see being built into RIIO-3 proposals. We suggest that an assessment of any impacts on consumers from the existing processes is undertaken including an assessment of the root cause of the length of the process. It may well be that this has already been undertaken and, if it has, we would welcome Ofgem sharing its assessment.

Question 8: What are your views on our proposal for 'shared drivers' projects, how TOs need to evidence investment requirements and how they can be held to account for delivery?

We strongly support the concept of shared driver projects or site strategies. We have experienced the complexities of multi-driver projects at shared transmission sites between transmission and distribution and welcome clear consideration of such challenges as part of the RIIO-3 development.

There are a number of ways in which these could be accommodated within the framework. Mandated site strategies, or specific site plans submitted as part of business plans could be options, and we support the ability to adjust funding through re-openers to accommodate emerging requirements in period so that consumers/companies do not have to wait for future price controls to initiate/benefit from such works. Shared driver projects can drive efficiencies and consumer benefit but are often restricted by the confines of regulatory reporting and/or mechanisms. Therefore we welcome consideration of how the framework can incorporate such initiatives.

DNO input into site strategies and shared driver projects are critical to ensure maximum efficiency and delivery of a whole electricity system outcome.

4 Minimising networks' impact on the environment

Question 10: What are your views on our minded-to proposal of retaining the IIG ODI-F during RIIO-ET3, and our additional commentary around the incentive and its associated reporting requirements?

As we refer to in our responses to OVQ20 and OVQ21 we do not believe that any incentive for Insulation and Interruption Gases (IIG) should be considered in isolation, and instead a broader review of the networks environmental impact should be undertaken to inform the most appropriate

incentive framework for this area. Whilst we recognise the relative importance of IIGs including Sulfur hexafluoride (SF₆) due to their impact and therefore the heightened profile of this area, it is not one to look at in isolation whilst developing the RIIO-3 framework. This is still the case even if the conclusion is that the area is of such importance that it merits its own distinct ODI-F. We also recognise the significant dependency on the fluorinated greenhouse gases (F-Gas) regulation and its implementation.

We know that stakeholders highlight SF₆ as a significant area of interest and therefore the approach to managing the impact of its use and leakage performance are critical components of any reporting framework to be put into place.

Question 11: What are your views on retaining funding to support mitigation projects that reduce the visual impacts of existing infrastructure in designated areas?

We support the retention of funding for the mitigation of visual impacts of existing infrastructure. Through our ongoing stakeholder engagement process, consumers and stakeholders tell us that they value investment in this area. We do recognise that there are different challenges and considerations when undertaking work on transmission infrastructure compared to distribution infrastructure which need to be considered when making decisions on the framework for RIIO-3 and ultimately RIIO-ED3 in due course.

We agree that sizing the RIIO-ET3 provisions must take account of contemporary customer willingness-to-pay for improvements. We highlight that this willingness-to-pay should not be restricted to transmission infrastructure only, but should account for all electricity overhead line equipment, including that of the ED companies. Potentially, due to the extremely high cost of mitigating transmission overhead lines, the more cost-effective visual amenity improvements can be achieved by mitigating DNO equipment on the ED network, which can also include steel tower routes. Because of the bespoke nature of transmission projects for visual amenity, the site-specific willingness-to-pay compared with the specific project cost should be investigated, especially where solutions involve high cost engineering such as cable tunnels in one area where lower cost mitigation measures might suffice elsewhere which have a better willingness-to-pay to cost ratio.

We note that the existing ET mitigation programme results in highly targeted and relatively restricted undergrounding, which leaves large areas of the country untouched (such as the North West). We suggest that an equivalent level of funding for the DNO undergrounding scheme would not only generate greater overall amenity benefit, but a far more diversified one, ensuring that all areas of the country benefit. Taking a whole system approach to this output area could deliver significant benefits for consumers if appropriately managed.

The new Levelling Up and Regeneration Act 2023 now requires statutory undertakers to ‘further’ the purposes of National Parks and National Landscapes rather than simply ‘have regard to’ as previously which needs to be considered alongside customer willingness-to-pay. This change should be fully considered when setting an appropriate regulatory framework in this area.

Question 12: Do you agree with our assessment of the bespoke outputs described in Table 7?

Whilst the bespoke environmental outputs listed in table 7 were, from the descriptions shown in the table, the most appropriate way to manage company specific outputs for RIIO-2, we agree there is merit in considering whether these should be common for RIIO-3 so that consumers across all areas can benefit from these initiatives.

The exception to this would be the following for NGET:

- We agree with the expectation that the PCD for NGET on reducing emissions from operational transport would not be required for RIIO-ET3 as this was directly linked to RIIO-ET2 expenditure commitments.
- We agree the SF₆ Asset Intervention PCD and re-opener may have merits in retaining on a bespoke basis for NGET given the volume of their assets, however as Ofgem indicate, this should be judged alongside other wider considerations on SF₆ more generally.

5 Energy Not Supplied (ENS) Incentive

Question 15: Should we retain the ENS incentive as an ODI-F and strengthen performance targets, or transition to a minimum obligation standard?

It is our position that Ofgem should keep the Energy Not Supplied (ENS) incentive as an ODI-F.

As evidenced across the electricity industry, the use of meaningful financial incentive mechanisms to improve network performance, when set at appropriate levels (i.e. strong enough to motivate the network operator and to justify the capital investment necessary to deliver the improvement) has been hugely successful. Network operators have delivered year-on-year performance improvements across both transmission and distribution. As with all incentive mechanisms, the key to their success is establishing performance targets that strike the right balance between the need to be challenging avoiding rewarding companies for delivering a normal level of performance (which is in the interests of consumers) while being achievable (which is important if the incentive mechanism is to avoid becoming largely about penalty avoidance). To date, Ofgem has in the main got this right, delivering performance improvement incentive mechanisms which have delivered significant improvement in network performance outcomes.

It is entirely appropriate that the structure of the incentive mechanisms is routinely reviewed, (i.e. adjustments to the target setting methodologies and to the incentive rates etc.) the use of a mechanism to drive further improvement remains broadly sound.

To ensure the incentives continue to deliver outcomes for consumers while encouraging network operators to invest, Ofgem should work with network operators to review the target setting methodologies and the associated incentive rates. Using an alternative minimum obligation standard would be taking a backward step in how Ofgem regulates the performance of networks, causing a slowing down of the creation rate of consumer benefit.

Notwithstanding the key question of who decides what a minimum standard should be and how this standard is derived for individual networks, it risks removing the likelihood of performance improvement in the future, for example through the use of innovative techniques and technology to improve the network. The advancements in technology and techniques in RIIO-1 and RIIO-2 show that there is huge potential and network operators should be strongly incentivised to pursue these opportunities.

Question 16: Are either a rolling baseline target or the addition of an improvement factor appropriate changes to the incentive target calculation methodology given the increases in target outperformance?

We believe the addition of an improvement factor may be appropriate, but that a rolling baseline target is not.

The addition of an improvement factor could represent an appropriate change to the current ENS incentive target calculation methodology. This would bring the methodology more in line with that used by Ofgem in RIIO-ED2 for setting targets for Interruptions Incentive Scheme (IIS). In determining the rate of improvement to be applied, for the reasons set out in our response to ETQ15, Ofgem should consider the wider performance target calculation methodology and not just apply an improvement factor in isolation.

Using a rolling baseline target, particularly where the target is not set on an ex-ante basis and reset annually based on the previous year's performance, would have the effect of neutralising any incentive entirely. It would instead become a mechanism where the target is entirely a function of the previous year's performance and any rewards from outperformance would be taken away and, conversely, underperformance would be rewarded through easier targets in subsequent years. Network operators would have little incentive to improve. There may be situations where network allow performance to worsen in one year if that means less challenging targets in subsequent years.

For clarity, we are opposed to in-period dynamic targets for the reasons set out above and a rolling baseline is effectively a dynamic target.

Question 17. Would a change in the estimate of the VoLL impact TOs investment decisions, and should the incentive value methodology be updated if the VoLL is changed?

We support the retention of Value of Lost Load (VoLL) as a measure, and that the ENS incentive value should continue to be calibrated to VoLL. VoLL needs to be representative of the consumer valuation of electricity in an increasingly electricity-dependent society. A single VoLL is not representative of individual customer experience and circumstances, so Ofgem should treat it as a baseline reference value.

The incentive value, in combination with the cost of network investment, is key to facilitating investment by the network operators.

For RIIO-ED2, Ofgem decided against recalibrating or making adjustments to the IIS incentive value methodology, rolling over into RIIO-ED2 the approach used in previous price controls. This has resulted in an approximate 35% weakening of the RIIO-ED2 incentive rate compared to RIIO-ED1. When this is combined with the increased cost of the associated network equipment, e.g. network automation, and the shortening of the price control period from eight years to just five for RIIO-ED2, it significantly weakened the business case for network performance improvement projects. This is perhaps counterintuitive for current and future price controls where an energy transition is occurring, where consumers are increasingly reliant on electricity to heat their homes and power their cars.

Therefore, we would support the recalibration of VoLL for RIIO-3, updated to reflect the changes in consumer valuation of electricity in the context of an ever increasingly electricity-dependent society.

Question 18. Are the current definitions for excluded and exceptional events sufficient, or should they be changed for RIIO-ET3?

Exceptional events thresholds are an important element of successful performance incentive mechanism, and it is crucial they are calibrated for the level of overall network risk. It is important that companies are not exposed to penalties for events which are outside of their control or represent circumstances for which the network is not designed to withstand.

As the risk for transmission differs fundamentally from distribution, we will not comment on the need for change. However, we would expect exemptions to be included in the mechanism as appropriate for RIIO-ET3.

Question 19. Should Ofgem add a materiality threshold for exceptional events?

Yes the addition of a materiality threshold is appropriate. As with the use of an improvement factor, Ofgem utilises materiality thresholds as part of its RIIO-ED2 network performance incentive mechanism, IIS and we recommend Ofgem consider its relevance for RIIO-ET3.

6 Connections incentives

Question 22: What are your views on the extent to which fundamental reform of the ET connections incentives is required, and how would you approach that reform?

We agree that there appears to be an inconsistency between positive TO performance and the unprecedented challenges that there are in getting connections due to constraints on the transmission network. This may be due to limitations in the incentive mechanisms as commented on in the question responses to ETQ23 and ETQ24. Ofgem is undertaking a review of connections incentives which we are contributing to as well as action plans being delivered by industry. We suggest this work is used, if timing permits, to inform the development of ET connections incentives. Should the work across Ofgem and industry on connections incentives not be completed in time then we recommend Ofgem is clear when setting RIIO-ET3 that changes to incentives are likely to follow and by what process and timescales this will occur.

Question 23: Do you have views on how the Timely Connections incentive can be reformed, or replaced, to better capture the efficient coordination of network offers?

Despite its name, this incentive mechanism only covers the first part of the process (i.e. for the customer to receive a connection offer). Whilst this is important, there does not appear to be any mechanisms that covers the rest of the process.

In terms of the current mechanism, we believe that there are two aspects of how the mechanism works that contribute to the observed good performance. Both points relate to how the 'clock start' is set to measure the timescales.

- The application must be deemed competent before the clock starts. The timing is based on when the application is reviewed, rather than when the information is received e.g. if it takes a month before the application is reviewed, that is when the 'clock start' date is set, even if the application is complete.
- The application must be paid for before the clock starts. The need for invoices to be raised and paid delays the recorded clock start time and may therefore make the recorded time for compliance shorter than the actual elapsed time.

Another aspect of the incentive is that it is based on a percentage performance. This means that the financial penalty attributed to any given connection offer that is not made in a timely basis can vary depending on how many have been successfully made. A fixed value for every untimely offer may have greater incentive properties.

Question 24: Do you have views on how the QoCS incentive can be reformed, or replaced, to better capture the service that connections customers receive?

The principle of a customer satisfaction survey remains valid, but we recognise some of the challenges.

Connections to the distribution system that require transmission impact assessments (e.g. embedded generators) do not appear to be included in the survey.

For ED, the Major Connections survey, which was introduced for RIIO-ED2, is a penalty only incentive. It also has some clear criteria for statistical robustness in anticipation of issues with low survey response volumes such that if the set threshold is not reached no penalty is issued even if the recorded score is below the target. This approach could be considered for relevance to ET.

A requirement to have a single provider carrying out the surveys would bring greater consistency and shared best practice. It is unclear whether common survey scripts are used to ensure no bias is inadvertently introduced.

7 New Infrastructure Stakeholder Engagement Survey ODI-R

Question 28: What are your views on whether and how TO customer service performance should be incentivised or enforced during RIIO-ET3, over and above the incentives and obligations described elsewhere in this chapter?

Our suggestion is that Ofgem should consider whether an incentive mechanism similar to the RIIO-ED1 Incentive on Connections Engagement (ICE) is introduced for TOs. Following its introduction, ICE dramatically changed the way DNOs engaged with its stakeholders.

In summary, ICE required:

- Each DNO to plan and to engage with its stakeholders to identify their key wants and needs.
- The DNO then needed to develop a plan to address those wants and needs and have the plan endorsed by stakeholders and then published.
- The DNO would then need to deliver the commitments made and report on them.
- Ofgem would then seek feedback from stakeholders to see if they felt that they had been engaged with, listened to and the commitments delivered to their satisfaction.
- Ofgem would then consider whether any penalty would be imposed on the DNO (no reward was available).

ICE resulted in much greater stakeholder engagement and identified key issues that affected stakeholders resulting in improved services. As it was an annual process, emerging issues could be identified by stakeholders.

We think the characteristics of ICE could be beneficial to be applied to the TOs. We would note that this should include customers that are researching into/intending to connect to the distribution system in a way that are impacted by transmission (e.g. embedded generators).

8 Cost of Service

Question 31: Do you have any views on how the cost assessment methods used in RIIO-ET2 for load and non-load capex could be improved and/or simplified for RIIO-ET3? Do you think we should consider alternative and/or supplementary approaches to the assessment? If so, which?

It is important that any decision on cost assessment treatment for load are made cognisant of the decisions resulting from the proposals set out in chapter 2 of the same annex.

We note that in table 8, load and non-load required differing approaches for companies because of “issues with reported data”. As a point of principle Ofgem should seek to remediate any issues with reported data ahead of business plan submission. This should include clarity and transparency of data required for business plans (including for cost assessment purposes) and the form in which it is required to be submitted.

Question 32: Linked to ETQ30, do you have any views on how the cost assessment process could be adapted to capture multiple drivers and address the needs of evolving cost categories for 'shared drivers' schemes?

Shared driver projects can drive efficiencies and consumer benefit but are often restricted by the confines of regulatory reporting and/or mechanisms. We welcome consideration of how the framework can incorporate such initiatives. Our response to this question should be read in conjunction with our response to ETQ8.

Ultimately a cost assessment process which assesses costs at a Totex level removes the need consider multiple drivers or needs in a cost assessment process. This is because assessing at a Totex level inherently captures trade-offs between cost categories and reduces the issues of where and how to apportion cost across differing cost categories where multiple drivers are present. For clarity we do not support an approach which is wholly or singly driven by a Totex model, but this shows the importance of Totex approaches in the cost assessment toolkit.

Ofgem should also consider the discussions and approach to incremental costs in the RIIO-ED2 price control. This may serve some insight or cross over to RIIO-ET3 where multiple drivers or benefits of expenditure as well as how these are treated in cost assessment has been considered previously.

Question 34: Do you have any views on how the cost assessment methods used in RIIO-ET2 for network operating costs could be improved and/or simplified for RIIO-ET3? Do you think we should consider alternative and/or supplementary approaches to the assessment? If so, which?

We would note that, for ED, inspection and maintenance costs are often the most effective means of ensuring longevity of assets and that intelligent decisions are made in terms of investment prioritisation to maximise the effectiveness of interventions. Also for these cost categories, growth is likely where the maintenance requirements for new smart devices and monitoring equipment is needed reflecting increased digitisation of networks.

It is important that the approach to assessing costs adopted by Ofgem in these cost categories considers these dynamics and understand that they are often facilitators of cost reductions in other parts of the cost base.

Question 35: Do you have any views on how the cost assessment methods used in RIIO-ET2 for indirect costs could be improved and/or simplified for RIIO-ET3? Do you think we should consider alternative and/or supplementary approaches to the assessment? If so, which?

Indirects and Closely Associated Indirects (CAI) as a cost category are usually a mix of functions driven by the factors such as the size of the existing asset base. Importantly these are strongly correlated with the volume of work being delivered, or to be delivered, as demonstrated by activities such as network design and project management costs. This is evidenced by the inclusion of an Opex escalator for RIIO-ET2 and an indirect scalar for RIIO-ED2. Further to this, it is likely to be impacted by company decisions on outsourcing/insourcing of functions given the activities which are captured in this cost category.

As such, any specific indirects or CAI modelling results should not be treated in isolation or based on one single approach within the cost assessment toolkit but be considered in the context of the activities with which they are closely associated to giving a rounded view of efficiency.

Question 36: Do you have any views on how the cost assessment methods used in RIIO-ET2 for other costs could be improved and/or simplified for RIIO- ET3? Do you think we should consider alternative and/or supplementary approaches to the assessment? If so, which?

We would note that Ofgem needs to carefully consider the modelling of Business Support Costs (BSCs) for all sectors.

BSCs are an important part of the cost base which are affected in some sectors, such as ED, based on the dynamics of licensee size and whether they are part of a Group of network licensees. BSC costs are incurred at sector Group level, rather than at a licensee level where this fact has been recognised by Ofgem explicitly in DPCR5, RIIO-ED1 and RIIO-ED2 as well as being noted by its own consultants in RIIO-GD2.

It is important that the dynamic of licensees that can benefit from scale economies by being part of groups within sectors is recognised and we therefore fundamentally maintain that Ofgem should model BSC at a Group level within sector recognising this relationship.

Modelling at the Group level within a sector avoids cost allocation issues where BSC costs are shared across the Group based on potentially arbitrary cost allocation rules which are likely to be inconsistently applied.

Question 37: Do you have any views on how to evolve MEAV as a scale driver for RIIO-ET3? What other scale drivers could we consider?

We note that Modern Equivalent Asset Value (MEAV) can be a subjective measure of a company size where decisions on what assets to include and the unit rates to apply has a level of optionality. It is becoming of increasing importance that the 'right' MEAV is used where the relevant adjustments to MEAV are undertaken before it is used as a cost driver. We would note that RIIO-ED2 represents a good example of this and support the steps which Ofgem took and applied to MEAV in its Final Determination of that process.

Alternatives to MEAV have been considered by Ofgem in previous price controls such as customer numbers which represents a potentially simpler dataset. We remain of the position that until a suitable alternative is demonstrated, that MEAV continues to be an appropriate approach as used in

RIIO-ED1 and RIIO-ED2. We would note that that this is the case for ED where most of the current costs are a function of the current asset base and need to be assessed in that context.

We further note that despite extensive discussion in the Cost Assessment Working Group (CAWG) for RIIO-ED2, no practical alternative was able to be established that was demonstrably better than MEAV. It is important that these discussions are held for all sectors and represent the dynamics in that sector specifically. Ofgem should not consider that a cost driver is appropriate for another sector just because it is applied to a different sector without testing it for the data and dynamics that are present.

Finally, the benchmarking of future costs needs to consider future drivers, particularly in specific areas and the requirements of the sector in question.

Question 38: Do you have any views on how the cost assessment process could address the market volatility and supply chain challenges that the sector is facing?

Our view is that cost assessment processes for setting ex-ante allowances should not necessarily need specific mechanisms or constructs within them to address market volatility and supply chain challenges so long as a robust Real Price Effect (RPE) mechanism is included in the framework. Adjusting for RPEs or input price pressures faced by network companies in addition to the level of general inflation are crucial to ensuring that network companies and their allowances are adjusted to reflect factors in their cost inputs that are outside of their control such as those as a consequence of market volatility and supply chain challenges. We set out our thoughts on this in more detail in question OVQ44, but note that an in-period uncertainty mechanism could be useful where the RPE does not reflect the actual costs as established by the competitive market.

It is important that Ofgem is able to set out how they will assess and account for RPEs in the event of ex-post assessment of costs. For example, where an evaluative PCD is assessed after the event of delivery for efficiency it is crucial that Ofgem is able to, and do account, for market conditions when the output was delivered and not necessarily the forecast market conditions at the point of which allowances were set. Failure to do this could result in costs being deemed inefficient when in fact they were efficient when the activity occurred based on the market conditions at that time.

Question 39: Do you have any views on our initial thinking around the role and potential evolution in RIIO-ET3 of the UMs listed in Table 9?

We note that the use of UMs has increased in RIIO-2 compared to previous price controls and are supportive of the drive to simplify these for RIIO-3 through consolidated and broadened UM scope. This would make the regulatory framework more manageable and therefore avoid complexity in the re-opener/ volume driver processes.

It is important that the regulatory framework and the sector specific ET UMs evolve for RIIO-3 to take into account the new CSNP. It is also important to gain clarity on whether the ASTI still has a role for the ET sector in RIIO-3 and how this may impact the framework and UM requirements.

We also note that work mix across the sectors may also vary more for RIIO-3 than for RIIO-2 and it is important that the overall UM package for RIIO-3 is looked at holistically to ensure it works appropriately for each sector, companies, and consumers in turn. This is of increased importance where UMs are consolidated, and scopes broadened to ensure no internal conflicts are created or that uncertainties are missed between UM scopes.

It is crucial that the UM overall package should clearly recognise sectoral differences and be developed on that basis.