

# Sector Specific Methodology Consultation response

## Appendix 1: Response to Overview

March 2024



## Contents

1	Introduction .....	3
2	Future of Gas.....	3
3	Role of Scenarios and Planning Pathways .....	5
4	Output and Incentives.....	7
5	Truth Telling and Efficiency Incentives .....	18
6	Managing Uncertainty.....	22
7	Cost of Service.....	26
8	Cyber Security .....	30
9	Innovation .....	31
10	Data and Digitalisation .....	36

## 1 Introduction

In this annex we set out our response to the questions in the Overview document 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 consumers, 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 Future of Gas

***Question 4: What are your views on the proposal of using the GD specific Heat Policy re-opener, the RIIO-3 net zero related UMs, or a mixture of both to fund network costs incurred as a result of the government's 2026 decision on hydrogen for heating (where RIIO is deemed to be the most appropriate funding mechanism for these costs)?***

Please also see our combined response to questions 35 to 38 in this document and GDQ6 in our Gas Distribution response annex as these are all linked.

Any Government decision on hydrogen for heating in 2026 will not only affect GDNs but also DNOs and other licensees as any decision on gas inevitably has implications for electricity.

We do not consider that a specific GD Heat Policy re-opener is needed and agree with the Ofgem view that retaining a separate GD mechanism may not reflect the goal of streamlining the price control. To simplify the price control and to avoid multiple uncertainty mechanisms with potentially unclear boundaries, we consider that the Net Zero re-opener could be suitably used for any adjustments needed as a result of the heat policy decision. To enable the Net Zero re-opener to work as required, revisions should be made to allow it to be both licensee and Authority triggered, rather than Authority only as in RIIO-2. Our support for a combined Net Zero re-opener is contingent on it becoming a licensee and Authority triggered Uncertainty Mechanism (UM) as we do not think it

is viable to remain as Authority only. The most appropriate time for licensee windows should also be considered in the context of RIIO-3.

In relation to the other Net Zero UMs, should these continue then the purpose and use should be well defined ahead of GDNs putting their business plans in so that they can clearly see the framework to which they are working to and building their plans around.

With respect to the Net Zero and Re-opener Development Fund Use It Or Lose It (UIOLI) allowance (NZARD), we note in chapter 8 that this is proposed to continue to fund small Net Zero facilitation projects and early development work in RIIO-3 for the GT, ET and GD sectors. An equivalent UIOLI allowance was not granted to the Electricity Distribution (ED) sector for RIIO-2, meaning there is disparity between the sectors without a clear rationale for this difference. We agree with the proposal that this important UIOLI allowance should continue for RIIO-3 but that this should be extended to also include ED so that all sectors and their consumers are able to benefit from this work and none are unnecessarily excluded from the opportunity such a fund presents.

With respect to the Net Zero Pre-construction Works and Small Net Zero Projects Re-opener (NZASP), we consider that having multiple UMs for potentially similar purposes may cause unnecessary confusion and complexity. As this is for GD and GT companies only, we have limited awareness of how the re-opener has worked and been used, therefore have limited comments on its revision. We would add that the potential option of merging this with the broader Net Zero Re-opener merits further consideration and could be a way of streamlining the UMs whilst maintaining clarity on scope and purpose, though this would also require the need for the mechanism to be licensee triggered. We suggest that this is explored further during cross-sector working groups. Learnings from the application of pre-construction funding (PCF) in ASTI, or how the RIIO-ED2 West Coast of Cumbria UM has been designed (to allow an application for pre-construction, followed by full submission) could be relevant areas to review here.

There are a number of potential revisions to the Net Zero re-opener considered within the consultation, and we would support a full review of an appropriate mechanism that is able to accommodate changes driven by Net Zero targets and associated policies, heat policy decisions, the existing NZASP and potential changes driven by the Regional Energy Strategic Planner (RESP) outputs. The design of this new re-opener should not be simply retro-fitted into the existing Net Zero re-opener and instead be designed based on the uncertainties it is aiming to address. Materiality, licensee triggers and application windows should all be reviewed and put in place accordingly.

We note that paragraph 2.27 of the GD annex references a combined UM having an appropriate materiality threshold. Our position on materiality thresholds is that they should be considered both in the context of the sector and the nature of the uncertainty. Further, in setting any materiality threshold, the RIIO-GD3 package in the round needs to be reviewed and any common approach to materiality should not necessarily be adopted by default. In a lower return price control with potential for more reliance on uncertainty mechanisms or specific Price Control Deliverables (PCDs) there is naturally much less flexibility for companies to respond as they have done previously to changing environments.

We do not support applying any materiality threshold to a mandated, compliance and/or legislative requirement outside of companies' control. This has largely been applied for RIIO-2, but there are some inconsistencies which should be corrected for RIIO-3.

In summary our position in this area is:

- Remove the heat policy re-opener.
- Retain the Net Zero and Re-opener Development Fund UIOLI allowance (NZARD) and extend its application to RIIO-ED3.
- Develop a new Net Zero re-opener which is able to manage uncertainties driven by Net Zero targets and related policies, including heat policy, RESP output.
- Materiality, licensee triggers and application windows should all be reviewed and put in place accordingly to ensure the new UM is viable.
- Consider incorporating the Net Zero Pre-construction Works and Small Net Zero Projects Re-opener (NZASP) with the newly developed Net Zero Re-opener with potential ability to build in streamlined pre-construction applications.

***Question 6: Should RIIO-3 help to manage future gas network decommissioning costs? If so, do you have views on what these costs could be and what mechanisms should be used, including for anticipatory funding?***

We support having a level of alignment between any policy specifically on decommissioning costs and regulatory depreciation. Options to set the regulatory asset lives including profiling those appear to be the best policy lever to us. ED during RIIO-ED1 had an asset lives approach that transitioned from 20 years at the start to 45 years by the end of RIIO-ED1<sup>1</sup>.

We recognise the challenges the gas sector faces and within this unique context we consider regulatory depreciation could be considered as a way to manage the appropriate return of value to investors for gas networks. Therefore, asset lives should be reviewed for this coming round of gas price controls in that context. Such a review could also consider the merits of any profiling to ensure the correct cost recovery between current and future consumers.

We also see the costs of decommissioning are likely to be faced by the current asset owner so the decommissioning activities are likely to be captured within the scope of ensuring the whole life of the gas network asset is appropriately funded and would normally be added to the RAV in due course.

Just from the scale of the GD network and potential cost of decommissioning it, we encourage that innovation should be advanced and incentivised to minimise the cost to consumers of decommissioning. So, targeting consumer investment now on any innovative solutions could be a way to reduce overall decommissioning and the whole life costs of the GD network.

### 3 Role of Scenarios and Planning Pathways

***Question 7: Do you agree with the proposal to use the FES framework for selecting the RIIO-3 scenarios?***

We agree with the proposal to use the FES framework, especially for the transmission network planning given that FES has a dual purpose: to be used for transmission network planning, and to

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<sup>1</sup> See RIIO-ED1: Final determinations for the slow-track electricity distribution companies Overview (ofgem.gov.uk) table 5.1

inform national operability system (as clarified and standardised in FES-DFES alignment through ENA Open Networks WS1b in 2020-2022).

However, the network companies should also have the ability to use additional evidence to inform their business plans, e.g. Week 24 data submitted by DNOs, DFES data in potential cases where FES data is believed to provide less accurate granular information for local network planning.

***Question 8: Do you agree with the proposal to use FES Leading the Way as the planning scenario for ET in RIIO-3?***

We agree that if a single scenario is to be used at this stage to inform RIIO-ET3 plans this should be Leading the Way (LW). However, the assumptions in this scenario could bring risks in the facilitation of a Net Zero electricity supply landscape by 2035. More specifically, the LW scenario models accelerated decarbonisation of electricity supply, but there are more optimistic assumptions on demand efficiency/societal change resulting in lower assumptions of peak demand growth when compared to the Consumer Transformation (CT) scenario.

This, combined with the typical timelines for the delivery of ET network works (e.g. up to or even over 10 years) might pose a risk to deliver least worst regret network investment.

It is critical that the ESO communicates and continues wide stakeholder engagement on the assumptions around the FES 2024 pathways which move away from LW and other scenario assumptions in FES 2023. Our early engagement with the ESO has highlighted that the FES 2024 framework will have a completely different rationale where the use of pathways will aim to deliver a path to drive transmission network interventions that facilitate the transition to Net Zero for electricity supply and demand supplied by the transmission network.

Our recommendation is for ET to consider the LW scenario as the basis of their business plan submissions. However, they must have the ability to consider granular evidence (e.g. Week 24 submissions, DFES data) or higher certainty assumptions in those building blocks where the LW scenario might be considering very ambitious behavioural changes by network users compared to the CT scenario. In turn these behavioural change assumptions reduce the forecast peak demand on which network investment assumptions are made.

RIIO-ET3 is a pivotal time for investment and therefore the forecast assumption used is critical to ensuring the required capacity for a 2035 Net Zero energy system.

***Question 9: Do you agree with the proposal to use two FES planning pathways for the gas networks, ie Leading the Way and Falling Short as the additional common conservative scenario?***

Yes, as we view that these two scenarios (LW and FS) can reflect the uncertainties associated with future levels of gas demand, i.e. the LW scenario can reflect higher gas decommissioning costs versus FS scenario reflecting more limited changes to gas demand levels. We support an approach that considers the uncertainties around decommissioning interventions and costs. If something other than the FES is used for the gas price control it would need to be robustly justified with the reasoning clearly set out.

However, the local gas demand levels can differ from one region and/or more granular local area to another. Unlike ET and ED business plans where forecasting data and evidence of forthcoming plans is critical, what seems more critical for GD planning is the use of existing regional data. For example, in areas where gas demand is used to fuel flexible electricity generation (“peak generators”) it is expected that this demand will probably remain during RIIO-GD3, whereas in areas where gas is

used more for domestic heating there are associated uncertainties with UK Government's 2026 decision on the future use of gas for heating.

***Question 10: Is Falling Short the most appropriate common conservative planning scenario to be used for the gas networks? Or is a common gas network developed scenario more appropriate?***

We are not aware of the existence of an alternative common gas network developed scenario. If there is such a scenario, we do not consider that it has gone through the stakeholder engagement processes that FES and DFES scenarios to inform ET and ED plans go through.

Therefore, the Falling Short (FS) scenario appears a sensible starting point to define the common conservative planning scenario for gas networks. However, again we would welcome gas networks providing granular data/evidence from existing connections and regional differences that justify alignment/differences with the regional FS scenario data. As with our response to OVQ9, if something other than the FES is used for the gas price control it would need to be robustly justified with the reasoning clearly set out.

***Question 11: Is it feasible for all network companies to initially plan against FES 2023 before updating business plans in line with FES 2024, as proposed?***

We believe that it is technically feasible for all network companies to initially plan against FES 2023 before updating business plans in line with FES 2024 as proposed. However, there are pros and cons in doing so.

In terms of pros, this would provide an informed sensitivity analysis on how the latest FES 2024 data and crucially rationale of pathways differentiates network investment requirements.

In terms of cons, this process will force network companies to simplify their modelling approaches and potentially risk accuracy to some extent as they will be required to re-run their planning process to meet the timeline including the use of additional information (e.g. Week 24, DFES, other evidence, data).

Consideration of any benefit from updating plans for FES 2024 should be undertaken on a sector-by-sector basis, taking into account the benefit and risks of doing so. Any decisions taken for each of the sectors should not be precedent setting for any other sector, including for RIIO-ED3.

## 4 Output and Incentives

***Question 12: Do you agree with our proposed approach on the role, scope and format of PCDs?***

We broadly agree with the direction signalled by Ofgem.

It is important that PCDs apply where these add value to consumers and that these do not become a regulatory burden diverting effort from delivering for consumers and stakeholders. From our experience of RIIO-ED2 the use of PCDs has become too granular and widespread and we would support rationalisation in RIIO-3. It is important that PCDs are used in a targeted way, focusing on material areas and we would gently remind Ofgem of its threshold for RIIO-ED2 bespoke PCDs of investment greater than £15m as a reasonable starting point for consideration in RIIO-3, though this should be sector specific in its calibration. It is important that the materiality threshold is set at a meaningful level, and we note that this level is not set out in the SSMC nor has Ofgem provided its views on what it deems material in this area.



Furthermore, we do not support the use of sub-PCD components or bundling of PCDs which are aggregated under a single PCD. We agree with Ofgem that the use of PCDs should be streamlined reducing regulatory burden and it is important that removal of this practice is undertaken for RIIO-3. Therefore, on the same theme, the practice of linking PCDs with UMs and vice versa should also be limited in their application for RIIO-3.

As a DNO which has two bespoke PCDs in RIIO-ED2, we support mechanistic PCDs over evaluative PCDs as these are clearer and more transparent with limited hindsight risk from ex-post assessment of outputs. Our experience is that they focus innovative solutions in delivery maximising outcomes for consumers given the prescribed levels of input in the PCD. We propose that Ofgem should be focussed on developing mechanistic PCDs as its default and only apply evaluative PCDs where mechanistic PCDs are not feasible. Furthermore, we suggest that upwards flexing PCDs, where additional benefit is delivered and where consumer support can be evidenced, should be allowed for in the framework. This would allow licensees to deliver more than the original PCD prescribes where it can evidence the benefit and support of this increase.

Evaluative mechanisms can be subjective with an ex-post assessment risk meaning DNOs may not seek to innovate or deliver the best outcome during the price control period due to the risk of disallowance where the current nebulous innovation and efficiency concepts are applied. The licence and associated guidance documents need revision to ensure simplicity, transparency and clarity of expectations and requirements focusing mainly on Evaluative PCD conditions.

We note the stated removal of using PCDs to roll out or commercialising innovation projects though it needs to be clear how these activities occur or are allowed in the framework. In particular we welcome Ofgem's openness to considering a mechanism to enable rollouts of innovative solutions during price controls rather than having to wait several years until the next fixed price control process occurs ensuring consumer benefits are not delayed. Additional views are provided in response to OVQ57 and OVQ58. It is very unlikely that rolling out a new innovative solution will fall perfectly within a price control period, so consideration should be given on how best to support these kinds of rollouts over a duration that spans two or more price control periods.

***Question 13: Do you agree with our proposed framework for setting financial incentives? Are there any additional considerations that we should take into account?***

The incentives framework is essential to be correctly calibrated in a RIIO regulatory model. Ex-ante incentive-based regulation as practised in GB is one of the leading global approaches and so should be maintained. Incentivised rewards (or penalties) such as ODI-Fs are a key part of the regulatory proposition driving improved outcomes for consumers.

It is in this context that it is important Ofgem considers the dynamics of incentivisation as a complete package, including interactions between incentives as well as other aspects of the regulatory framework whilst also understanding impacts for consumers and stakeholders in the long term beyond the immediate price control in question.

In response to this question, we have broken our views down into subheadings based on incentive design components.

*ODI-Fs*

We agree that ODI-Fs are an important part of the incentive package. ODI-Fs should be predominantly metricised with limited use of subjective assessment elements. This is important for



transparency and clarity of requirements including the aim of the incentive and how it will be rewarded or penalised. As a single licensee, it is our experience that panel-based or subjective assessment elements mean larger grouped companies have a natural advantage through utilising pooled resources across several licences. This is through deploying the same solutions multiple times to each licensee and being rewarded for the same activities.

It is in this vein that we believe behavioural incentives are very difficult to establish successfully. We would support the inclusion of these where they can be metricised but where qualitative elements such as panels are the primary means of assessment then they are too subjective and not objective representing poor incentive design. We support the aims set out of these to drive increased collaboration and cross-network working but are cautious these are done in a way that is robust and fair to all networks and companies it applies to, including the impacts of each companies' group status and size.

There should also continue to be a place for well developed, strongly evidenced and consumer-supported bespoke incentives. There is already a high bar which was met by ENWL with the new ED2 bespoke Dig, Fix and Go incentive which is a regulatory innovation that otherwise would not have emerged and could potentially be applicable to other licensees and sectors in future price controls.

#### *Target setting*

The calibration of reward and penalty thresholds through target setting must be meaningful and achievable where performance improvement is stretching but feasible.

It is within this context that the use of frontier assumptions i.e. setting performance thresholds at the highest level achieved by an individual company in the period is not representative of the limitations of assessment and regulatory design. Frontier performance levels assumes a perfect incentive design and does not consider performance across all regulated activity. This risks cherry picking performance where it creates an unrealistic notional company expected to achieve frontier performance levels across all areas where the benchmark is likely to be differing companies in the assessment period with differing areas of focus driven by consumer and stakeholder requirements. This is exacerbated by allowances being set without reference to service levels achieved in the period creating a further disconnect between expected service levels determined through target setting and allowances established through cost assessment. It is the case that generally an Upper Quartile benchmark is appropriate for reward reflecting a stretching and improving level of service whilst the level set is feasible and meaningful, mindful of the limitations of the wider framework and its assessment process.

Furthermore, this is the reason why the use of out of sector benchmarking should be used carefully and only in circumstances where it is appropriate, i.e. where there is sufficient comparability between sectors including on dynamics and priorities. We currently see little evidence of there being many examples of this.

In addition, an appreciation and adjustment for regional context within bespoke or common targets is important when setting targets. In ED, the calibration of the Interruptions Incentive Scheme (IIS) is a good example of this in so much that the targets are set and calibrated accounting for companies' networks design and characteristics. Failure to account for such factors would penalise or reward companies for exogenous factors outside of their control.

We agree that there are alternative tools to the absolute level of target setting such as the use of deadbands. We also agree that deadbands have some validity but in our view only where there are

factors outside of network companies' control where network companies should not be penalised or rewarded for this. We disagree with the other two reasons<sup>2</sup> set out in the SSMC as these only serve to water down incentive properties without real benefits to consumers and stakeholders.

Finally, we would seriously question the use of dynamic target setting. Dynamic targets break the link between cost and service which is fundamental for companies to plan and optimise expenditure across all regulatory requirements and outputs cognisant of what is needed to be delivered at the outset of a 5-year price control period. This is also important in cost assessment terms where, as already stated, current cost assessment processes and allowance setting fails to directly account for individual or specified service levels. Given that performance improvement levels are reset in 5-year periods with improvements reflected in future settlements, the use of dynamic adjustments within this period is less pressing if there is a shortened review period such as 5 years. Consumer benefit is greater where this periodic review and reset is undertaken as it incentivises performance maximisation in period from all companies where targets are clear and transparent.

#### *Strength of incentives*

It is critical that Ofgem maintains, and in certain places strengthens the incentive-based regime as this drives improvement in consumer value and innovation in many key areas. Given the increasing criticality of energy to consumers daily lives, plus the vital importance of achieving Net Zero, we find it hard to comprehend that incentive packages should be getting smaller, they really should be increasing to reflect an overall growth in consumer need for transformational changes to the energy network which will be delivered in part through deployment of innovative solutions. Therefore, should Ofgem decide to remove or lower an incentive area from RIIO-2 to RIIO-3 we would strongly advocate that this is replaced with a new incentive area or an enhanced existing area. This should be done to align with the priorities of consumers, areas of focus for innovation, or the aims/ priorities of Ofgem for RIIO-3. This should also be considered in the context of the sector being looked at.

#### *Calibrating ODI-F incentive rates, caps and collars across networks*

Incentive rates should be reflective of the value to consumers. Reducing these down lowers the benefits delivered for consumers. The Value of Lost Load (VoLL) which underpins the Interruptions Incentive Scheme in ED is a key example of this. We note paragraph 6.81 *"It was noted that incentive strength is not always linked to consumer value or benefit. This could lead to the cost of meeting certain levels of performance exceeding the benefit to consumers from that improved performance."* We agree with the statement but would add that removing the link also essentially removes appropriate and evidenced incentive properties.

In addition to our comments above on the incremental rate of the incentive, it is important that absolute incentive caps and collars for the period are calibrated at a level which neither; exposes companies and consumers to costs which are 'excessive' based on in period performance, or at a level which forgoes additional benefits to consumers where these can be achieved in the period. On the second of these points, forgoing benefit in one period will also see this being lost from the next price control period where the targets are recalibrated, re-baselining expectations and locking in the benefits achieved in previous periods in perpetuity.

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<sup>2</sup> 1. for new incentives, where we were less confident in our target setting, and 2. for more mature incentives, where network companies were consistently achieving a good level of performance

*Rewards and Penalties.*

We broadly support presenting all ODI-F values as a percentage of RoRE, so long as there is no financial impact of the change on companies or the associated strength of incentives. In short, the change should be presentational in impact only.

***Question 14: Do you agree with our approach to setting reputational incentives? Are there any additional considerations that we should take into account?***

We broadly agree with the approach presented by Ofgem; bespoke outcomes/outputs present important opportunities for companies and networks to represent regional requirements and expectations as part of their business plans.

We would be cautious on using ODI-Rs as a sandbox for future ODI-Fs as a default, as the issues or concerns that the incentive is designed to address can be mitigated by appropriate incentive design for ODI-Fs in the first place, and as such it is important that new bespoke ODI-Fs are not immediately rejected or downgraded to ODI-Rs. Further to this it is unlikely that an ODI-R will gain a true view of its application for ODI-F in future under reputational ODI incentives, as the incentive dynamics are very different. Licensees will likely react differently to an ODI-R than an ODI-F, and so the results of an ODI-R will not be directly comparable to the results of an ODI-F.

***Question 15: Do you agree with our proposals for bespoke outputs? Are there any additional considerations that we should take into account?***

We agree with the general principles shared in the consultation and note that lessons were learned from the RIIO-2 early price controls and as such a limit with a high bar for application was instigated for RIIO-ED2 resulting in a reduced number of high-quality proposals. We were successful in our bespoke output submissions in RIIO-ED2 as reflected by our ODI-F 'Dig, Fix and Go' as well as bespoke investment programmes for 'Linesight' and 'Smart Street'. We submitted these fully cognisant of the high bar and limited our bespoke proposals to activities where this threshold could be met. The clarity and transparency of expectations are key in this regard, limiting the number of submissions by networks to those that are meaningful. From our perspective RIIO-ED2 was a good blueprint for this. We would note that based on our RIIO-ED2 experience an incentive strength threshold and minimum requirement of between 0.25% to 1% is appropriate.

As such we are pleased and support the statement in paragraph 6.103 that Ofgem "*recognise that network companies may have unique requirements and circumstances, based on their local geography and the needs of their local customers, that need to be reflected in the price control.*" We pride ourselves as being a community focused DNO operating in the North West and as a business we are keen to represent and deliver for our consumers and stakeholders. We have a unique position understanding our consumers and stakeholders wants and needs and undergo enduring engagement to ensure we are reflecting these and any changes as they evolve.

***Question 16: Do you agree with our proposal to retain the EAPs and AERs in RIIO-3? Please provide reasonings for your position.***

Yes, we are supportive of the proposal to retain EAPs and AERs for RIIO-3. Our consumers and stakeholders tell us they value this approach using clear targets and reporting on how we are performing in this important area.

The use of a common reporting format is preferable to increase transparency across the sectors.

***Question 17: What are your views on the new proposed AER format with Commentary and KPIs?***

We agree that the AER format proposed, comprising of both a commentary and KPIs will be conducive to greater transparency. During the development of RIIO-ED2, the AER format in this way was created and is already in place for the ED sector. We welcome the introduction of this build being adopted for the other sectors.

A common set of KPIs and common reporting are an important part of the reporting framework that can allow stakeholders to review performance with ease, whilst the ability to provide a broader narrative on their activities allows licensees to showcase what they are doing in their area, demonstrate company specific or regional initiatives and adds colour and additional insight where metrics are not always as expressive. We agree that a combination of reporting that allows both strikes the right balance.

***Question 18: Do you agree with our minded-to position of retaining the reputational incentive on TOs and GDNs for reducing their BCF?***

Whilst there is no doubt that a company's BCF is an important area that should have reduction targets and reporting on progress, we are unclear what additional benefit would be achieved by having this area separately identified for an ODI-R, over and above its clear inclusion in the TO and GDNs EAPs and AERs.

We understand that all TOs and GDNs set BCF reduction targets as part of their RIIO-2 plans, and these targets were independently assessed and verified by the Science Based Target Initiative. These targets are long term targets, not bound by traditional price control periods, and therefore are more enduring than regulatory time-bound targets.

We support BCF being a requisite part of an EAP required as part of RIIO-3 business plans, but do not see value on a further reputational incentive. This would streamline the RIIO-3 framework and avoid any risk of stakeholder confusion by having both an EAP, AER and then also a BCF ODI-R.

***Question 19: Are there any other suggestions you would like to make regarding reporting standards?***

We support the principle of transparent common reporting principles however also recognise that there are still some emerging areas, where maturity of measurement is not yet sufficient to have robust and comparable data appropriate for use in KPIs. In these cases, the commentary component of the AER is valuable to explain companies progress in these areas. Ofgem and companies should not wait until a new price control to develop common methodologies and instead, this should be driven in period as continuous improvement and data becomes available.

***Question 20: Do you agree with our minded-to position to withdraw the Environmental Scorecard and incentivise improvements in environmental impacts through the Annual Environmental Report (AER)? Please explain your reasoning.***

We recognise the strong support and emphasis that consumers and stakeholders place on managing the impact of a network's operations on the environment. There was support for the Environmental Scorecard in RIIO-2, and a similar approach was also explored for RIIO-ED2, but ultimately not progressed.

We believe that this is a key activity area, particularly taking into account the scale of activities expected across the transmission networks, and therefore would urge caution on removing any financial based incentive for RIIO-3. Our response to OVQ21 provides further comment.

***Question 21: Do you consider that there are other areas which require financial incentives which cannot be captured by the AER? Please explain your reasoning.***

Financial incentives are a fundamental component of the RIIO regulatory model, and we are supportive of the use of financial incentives to drive improved outcomes for consumers. There is no doubt that protecting the natural environment is of both benefit and increasing importance to consumers. The use of financial incentives in this area should therefore be seriously considered by Ofgem as a means to drive increased benefits and improvements for all consumers and stakeholders. Areas that support achievement of Net Zero and licensees' science-based targets should be areas of focus, although other environment areas of focus should also be in scope. Learnings from the RIIO-2 period for the TO and GDN sectors and the environmental scorecard should be used to consider how a financial incentive in this area could be suitably developed. Further, the IIG ODI-F in place for TOs and covered in question ETQ10 should be considered alongside any financial incentive so that environmental impacts as a whole are considered together, rather than being looked at separately. This holistic approach could also support the aim to streamline the RIIO-3 framework.

For RIIO-ED2, it was determined that there was not sufficient breadth or maturity of measurement to give confidence in setting a financial incentive on environment, however as learning continues and measurement methodologies and standardised reporting is obtained, this should be reconsidered for potential development and application for RIIO-ED3 as well as for the other RIIO-3 sectors.

***Question 22: Do you have any views on our proposals for the NARM framework?***

We are supportive of the continued use of the NARM methodologies and the view that updates to these methodologies will be evolutionary into RIIO-3. We are comfortable that the approach laid out in the NARM Funding Adjustment and Penalty Mechanism is fit for purpose and could be applied to the ED sector, although we note that the NARMS handbook does not currently reference ED, particularly in respect of deadband values. We are also supportive of the ambition to expand the coverage of the NARM methodology and we will continue to engage with Ofgem through the NARMS Electricity Distribution Working Group (NEWDOG) to explore opportunities in this regard.

However, in reference para 6.150, it is our view that the NARM methodology is by its nature a CBA and it should not therefore be necessary to provide additional CBAs or EJPs to justify asset replacement investment in assets covered by NARMS. The exception to this would be where an investment is not fully justified on the basis of NARMS and a licensee wishes to take additional factors into account in a specific case.

***Question 23: Do you have any views on our proposed long-term approach to embedding climate resilience, including the principles for embedding climate resilience?***

As a general principal we support the Ofgem proposed long term approach to climate resilience as these build on the work that network companies have undertaken since 2008 in reporting to Defra under the Climate Change Adaptation Reporting (CCAR) requirement.

We have specific concerns about the design of a metric to measure resilience; it needs to be of a form that will provide companies with sufficient information to make decisions that will improve service to consumers and enable Ofgem to measure these improvements.

Because of the complex nature of the climate risks that network companies face and the diverse geographical nature of companies it is proving difficult to identify a measure that will provide better guidance than the policies and processes that companies are currently using. We welcome the commitment of Ofgem (6.161) to work with network companies to further develop the scope of forward-looking climate metrics.

Looking at paragraph 6.155 it is important to note that network companies had been reporting on the risks associated with “*increased temperatures, prolonged rainfall, wildfires, drought, lightning, sea level rises and prolonged rain*” as part of the three rounds of reporting reports to Defra in 2011, 2015 and 2021. The risk assessments in these reports identified flooding and vegetation management as the major issues that needed to be addressed, which is why allowances were requested as part of companies’ price review submissions (6.154).

In these reports companies noted that the frequency of storms was forecast to increase, but not the intensity, but also identified that current climate projections did not provide enough information to assess risks from multiple threats combining, such as high winds following a period of prolonged wet weather or snow and wind over a prolonged period. The events associated with Storm Arwen reinforced the need to work with industry colleagues, academia, and experts to help understand these combined risks.

In response to Ofgem’s request to establish a ‘climate resilience’ working group, the existing ENA Climate Change Adaptation Reporting Working Group has already evolved to become the ENA Climate Change Resilience Working Group. Although one focus of this group was to identify a resilience metric for ED companies, the group continued to consist of representatives from both GD GT and ET companies.

Regarding each of the proposed principles (6.157):

*climate resilience decisions need to be based on forward-looking data and information. This is especially important as climate change is expected to bring unprecedented extreme weather and variability which means information based on the past is not a good indicator for the future;*

In assessing risks to networks, as part of the CCAR work, network companies used the Met Office UK Climate Projections published in 2009 (UKCP09) and updated in 2018 (UKCP18) as the basis for analysis, identifying potential climate scenarios to the end of the century. We support the continued use of long-term forecasts in decision making, noting the requirement to improve the understanding of how different elements of climate interact.

*high impact, low likelihood extreme events (based on latest understanding of climate science) need to be considered in light of the more frequent and severe extreme weather expected;*

We agree that this type of event needs to be considered and look forward to discussing with Ofgem the number of credible ‘high impact, low likelihood events’ that could be modelled and how allowances can be allocated or allowed for to mitigate the potentially enormous impacts of these unlikely events.



*the costs and benefits of adaptation actions and their impact on resilience (ie avoided costs) need to be correctly valued. This includes understanding the impact actions will have on improving levels of resilience over the lifetime of the asset and capturing indirect (eg impact on other sectors) as well as direct avoided costs;*

We look forward to working with Ofgem to develop CBA tools which ‘correctly value’ the impact of large-scale interruptions, particularly the ongoing impact on industry and other sectors. The VoLL to industry is significantly different to that of domestic consumers and needs to be investigated for future planning purposes.

*investment decisions need to be fit for purpose for the decarbonised energy system. In particular, the increased vulnerability of the system to climate risks, whilst we transition to net zero need to be considered.*

As heat and transport are decarbonised the reliance on electricity networks will continue to grow. Coupled with the increased reliance on IT and communications to access vital data and to manage processes, we expect that tolerance for even the shortest interruptions will gradually disappear over the next century. Consequently, we will need to invest as a society to improve resilience. A debate is needed on where responsibility for resilience sits; what additional requirements should be placed on network companies and what reasonable provisions should consumers make.

Publication of a climate resilience strategy, as described in 6.159, is useful in summarising all the work that network companies are doing and would like to do to improve resilience. We have concerns about the form of a climate resilience metric, which are covered in more detail in our response to question OVQ26.

As noted above and in 6.162 there is a great deal of uncertainty regarding setting resilience standards, so we believe the proposed broadened resilience re-opener is a sensible approach which we support.

The impact of Storm Arwen and other severe weather events has focussed attention on the resilience of networks and the need to improve the experience for consumers. We are committed to continue to improve the resilience of our network and support measures in the RIIO-3 and in due course RIIO-ED3 price controls which will help to achieve this.

***Question 24: Are there any early learnings we should be aware of/incorporate to make progress on this in RIIO-3 or beyond?***

Many of the Ofgem proposals build on the decisions applied for RIIO-ED2. Because GD and TO companies are already active in the ENA Climate Change Resilience Working Group they have been involved in the discussions on potential metrics, so will be aware of the issues involved.

***Question 25: Do you agree with our suggested approach for embedding climate resilience into RIIO-3, namely: introducing resilience strategies; developing forward-looking resilience metrics; and introducing climate resilience working groups?***

As noted in our response to question OVQ23, we are generally supportive of the approach Ofgem to climate change resilience. We cover the three specific items set out below:



### *Introducing resilience strategies*

We see the company Climate Resilience Strategies as an evolution of the Climate Change Adaptation Reports which companies have submitted to Defra over the last 12 years. We support the introduction of strategies which can be updated on a more regular basis.

### *Developing forward-looking resilience metrics*

We understand the desire to have a measurable metric but the experience in the ED sector is that it is difficult to define a measure that is meaningful and useful. We describe some of the issues involved in our response to question OVQ26.

### *Introducing climate resilience working groups*

The ENA Climate Change Resilience Working Group has been a useful forum for discussion on the risks that network companies and strategies. With the forthcoming changes to the ENA in 2024 consideration of how this work continues in a co-ordinated cross sector manner is needed.

We believe that there is sufficient synergy between the ET and ED sectors that a single climate resilience working group would be appropriate for both sectors.

### ***Question 26: Do you agree with the proposals that we have set out around the resilience metric?***

Through the ENA Climate Change Resilience Working Group we have been actively involved in the discussions regarding the development of a resilience metric for ED for the last three years. Whilst a great deal of effort has been put into discussing potential metrics, there is still no clarity on what a useful metric would look like.

Companies currently manage resilience through its component parts, generally by making sure that all assets comply with the relevant standards, for example:

- ETR 138 - Resilience to Flooding of Grid and Primary Substations
- ETR 132 - Improving resilience of overhead networks under abnormal weather conditions using a risk-based methodology
- Network Asset Risk Metric (NARM) as a measure of condition-based risk

To be effective a new metric would need to:

- give an accurate representation of all aspects of a network's resilience
- provide improved information to that network which would allow it to provide better service to its consumers during extreme events
- allow network companies to justify expenditure on resilience
- allow Ofgem to monitor improvements in resilience

The first challenge comes with the definition of what resilience is. There are many academic and industry papers discussing resilience, the distinction between reliability and resilience, and how resilience should be measured. None are conclusive in providing a model to follow.

Some see resilience as being an extension of reliability, which is already addressed through the Interruptions Incentive Scheme (IIS) for ED and through equivalent schemes in other sectors. They

would suggest that numbers of customer interruptions and duration of interruptions could be a measure of resilience.

The question then is where does reliability end and resilience begin? Currently there are exemptions from IIS for severe weather events, but the judgement of what is an extreme event is judged purely on a numerical threshold basis. For example, if ENWL has 56 higher voltage events in a 24 hour period this is a severe weather event, but if we have 54 then it is a “normal” day in IIS terms.

A perverse outcome of this method of judging severe weather events in this way is that companies that have invested to make their network more resilient may expose themselves to more risk because that investment reduces the number of outages and moves performance in a storm to just below the threshold. We believe that discussions need to take place to assess the most appropriate ways to categorise severe weather events.

One of the problems associated with measuring the impact of resilience spend is that the events we are protecting against are very rare, so output-based metrics do not necessarily correctly reflect the benefits from the investment.

A theoretical example for ED which is a principle/ concept relevant to ET is as follows:

- two DNOs have substations which are judged to be equally at risk from flooding;
- DNO A decides not to invest any money to protect their substation;
- DNO B invests £1m to protect the substation against a 1-in-500 year incident;
- DNO A is not hit by a flood so suffers no interruptions;
- DNO B is hit by a 1-in-1000 year flood which causes multiple, lengthy interruptions;
- Because DNO A has not had any interruptions due to flooding, is its resilience strategy correct?
- Because DNO B has had interruptions is the £1m investment not effective and would the DNO's resilience performance be judged to be ineffective?

A metric would need to be able to assess whether investment has been effective, irrespective of whether a severe weather event occurs.

Another aspect that increases the complexity of any metric is the diverse geography and topology of our networks. For example, the resilience challenges for the 10% of our customers who live in predominantly rural Cumbria, who are served by a mainly overhead network, are different from the 55% of our customers who live in the Greater Manchester conurbation, where they are mainly served by underground cables.

Is it beneficial to have a single metric that reflects the resilience of our whole network, or do we need to sub-divide our network into areas with related resilience risks?

These factors, and many more, have been discussed whilst trying to develop a climate resilience metric for ED. Current thinking is that an outcome-based metric is not appropriate, so the measure would be based on compliance with standards. The approach to setting up a compliance-based metric would be:

- Identify all significant risks from weather related events, both in the current climate and in future scenarios.
- Ensure that a suitable engineering specification, or equivalent, exists that deals with that risk.

- Review that document to ensure that it is appropriate for current climate and considers how the climate will change in the foreseeable life of the relevant asset or assets.
- Through audit check that companies are compliant with those standards.

It cannot be stressed enough that the introduction of a metric can only be judged to be successful if it demonstrably improves the level of service that consumers would receive using current approaches.

***Question 27: Do you agree with our proposals on workforce resilience?***

We agree that there would be value in network companies working with relevant industry bodies to establish a consistent format for public reporting on an agreed set of key metrics. Ofgem previously completed workshops on the topic of workforce resilience for RIIO-ED2 development and we believe the outputs of those sessions should be the starting point for any new workshops, which we would support.

We feel that focus topics for any workshops may include:

- Specific skills shortages by trade and cross sector competition
- Key skills retention strategies
- Age profiles
- Diversity and Inclusion
- Future proofing skills for the energy transition

These workshops should not overly constrain or drive perverse behaviour because of their design. DNOs and network companies require the flexibility to develop their own resourcing strategies to meet the needs of the rapidly changing operating environment and delivery of capital investment programmes. The workforce roles will need to evolve and facilitate digitisation and future skills development.

In developing a set of metrics, it would need to be understood how the measure(s) would be used to identify new working practices and the benefit that it would bring to consumers.

## 5 Truth Telling and Efficiency Incentives

***Question 28: Do you agree with our proposed key objectives for truth telling and efficiency incentives?***

We broadly agree with the key objectives set out in the consultation; however, we have significant concerns about the terming of the ‘truth telling incentive’. Naming in such a way risks undermining confidence in the sector as well as creating adverse perceptions of network companies. Trust and legitimacy in regulated sectors is crucial, and Ofgem should not seek either inadvertently or by design to undermine this. ‘Truth telling’ suggests that in some way network companies seek to *not* be truthful in their business plan submissions to Ofgem. From our perspective this is not, and would not be the case, and our submissions represent faithful and accurate submission where we best seek to respond to the directions, incentives, and policy directions which Ofgem take, alongside stakeholder and consumer wants and needs.

There is a real risk that should Ofgem continue with ‘truth telling’ as the naming convention then this will adversely impact how we are seen by our consumers and stakeholders despite the excellent work undertaken by our sector to underpin trust and legitimacy in what we do. Further, this

reputation is crucial given the requirements and investment needed in the future to meet Net Zero policy aims. We would suggest reverting to 'business plan incentive' as a name which we feel balances the aims of the incentive with a name which is unlikely to adversely impact perception in the industry.

It is important that in achieving the key objectives Ofgem considers sector specific dynamics and in turn how this impacts the best way to achieve the stated objectives. We see that in sectors such as ED where there are a significant number of comparators enhancing the ability to undertake comparative assessment Ofgem should be able to set stronger upfront as well as in period incentives where confidence in benchmarks for items such as costs should be greater than sectors where little or no direct comparative assessment can be undertaken due to the number of companies operating.

It is in this context that Ofgem should not try to set a one size fits all approach to its 'truth telling' and 'efficiency' incentives which should consider both differential strength as well as approach to assessment of reward, penalty and calibration.

It is our position that there should be a real opportunity to differentiate ED when our sector methodology is considered given the unique nature of our sector with regards to comparator numbers, strategic requirements, importance in terms of Net Zero delivery and impact on consumers and regional stakeholders.

***Question 29: What are your thoughts on our proposals relating to minimum requirements under an evolved BPI approach?***

We agree with the direction of travel set out by Ofgem and support the aims of reducing/rationalising the minimum requirements criteria to those that are meaningful.

It is important that minimum requirements focus on elements where failure to meet them renders a consumer impact. We would suggest to Ofgem that this can be achieved by two routes:

1. Limiting a rationalised set of minimum requirements to those where a direct consumer impact can be determined ahead of companies submitting business plans, where these are set out explicitly upfront. These should seek to avoid including items that are procedural by nature i.e. failure to submit in a certain format where this has no impact on consumers.
2. And/or a set of minimum requirements that are rationalised but where assessment of consumer impact is assessed after the event (i.e. upon assessment of business plans). This would allow Ofgem to utilise discretion in whether a penalty is levied against a company who may have made a technical failure of minimum requirements but where there is no or immaterial consumer impact. This would have the benefit of allowing for circumstances where guidance on minimum requirements is ambiguous or can be interpreted in different ways.

***Question 30: What are your thoughts on an 'in the round' assessment of cost forecasts as opposed to a high/lower confidence breakdown and assessment?***

Our preference is for option 2 in so much that the assessment on cost ambition is undertaken 'in the round'.

An 'in the round' assessment in our view fits best with the principles of RIIO and a single till approach. A line-by-line assessment of cost categories including notions of high and low confidence as per RIIO-2 risks implications of reporting discrepancies and adversely impacting companies where

shared costs aren't suitably accounted or where there is a degree of influence where costs are accounted i.e. grouped licensees.

We would note that in the round assessment places increased emphasis on cost assessment approaches being robust and that the approach to cost assessment will necessarily differ between sectors due to the number of operating comparators. Where comparative assessment is undertaken it is important that this is done in a way where non-comparable costs are removed from assessment as this creates issues and potentially disincentivises companies from submitting innovative or unique investment projects which are driven by consumer and stakeholder requirements in their region.

To that end we support the removal of the Confidence Dependent Incentive Rate (CDIR) for RIIO-3. Of relevance is our experience of RIIO-ED2 where we submitted bespoke investment programmes for 'Smart Street' and 'Linesight' which were excluded from core cost assessment because of their bespoke nature, and it is important that this occurs for RIIO-3 as a principle. However, it is important that the negative impact on Totex Incentive Mechanism (TIM) is removed where 'Linesight' and 'Smart Street' in RIIO-ED2 rendered a lower TIM for ENWL through the CDIR as they were deemed low confidence costs because of their unique/bespoke nature. For RIIO-3, companies should not be penalised for submitting innovative consumer led investment programmes such as 'Linesight' and 'Smart Street' through reduced incentive strength as occurred in RIIO-ED2. It is to this end that we support removing the CDIR for an assessment in the round where the impact on justified consumer led investment is continued to be removed from cost assessment and isn't disincentivised through a negative impact on the efficiency incentive for a company in period.

Also, for comparative assessment, for sectors where it is applicable, where service or quality drivers are not included in the cost assessment processes it is important that the 'in the round' assessment of business plans considers both cost and service without this being done in isolation. Failure to do this could render an unreasonable assessment of plans as well as benchmarks where a company may be assessed as the best on cost but worst on service ambition, but the reward is given based purely on cost and a reward is rendered for this. The opposite is also true. In the round needs to be completely in the round where ambition and cost including inherent trade-offs are considered.

Finally, we support the use of quantitative assessment over qualitative or subjective assessment methods as a principle. It is important that the quantitative assessment method is set out upfront and where reward and penalties are reserved for those companies which are setting the benchmark in terms of their overall business plan or where they are failing to meet a lower threshold. For example, this could be set at thresholds i.e. reward for those in the upper quartile and penalty for those in the lower quartile based on assessment with companies in the middle receiving no reward or penalty. This approach would work well for sectors where there is a critical mass of comparator companies.

Ofgem need to consider whether fundamental differences in the sectors and how cost assessment processes are undertaken mean that a single approach to 'in the round assessment' is realistic, and that this should be necessarily different for each sector or based on a core set of principles for RIIO-3.

***Question 31: What are your thoughts on an 'in the round' assessment of business plan ambition as opposed to requiring and assessing CVPs?***

We agree with the removal of CVPs for RIIO-3.

Our view is that whilst the concept and aims were right for RIIO-2 the execution in practice, including the guidance and how these were assessed, meant that they added little to the regulatory framework. Therefore, Ofgem for RIIO-3 need to provide greater clarity and guidance to sharpen incentive properties when considering bespoke areas of consumer focus and outputs to avoid effort being placed in the wrong areas.

The concept of assessment 'in the round' for ambition is one we agree with but would require clear guidance on how the in the round assessment is to be undertaken to be set out upfront in the business plan guidance. It also needs to be an assessment where ambition and cost are not undertaken in isolation. We set out our views in more detail in OVQ30.

With regards to service and its assessment 'in the round', it is important that a defined level of service is agreed and included in plans. This would allow for a baseline to be established so that extra overs can be defined as ambition as well as being taken out of cost assessment where not comparable across companies. This would require clarity of expectations from Ofgem including the defined baseline service levels and how Ofgem are to assess ambition.

Whilst this would incur some interaction between minimum expectations and minimum requirements it is important to set out that that these are different in their aims from our perspective. Ambition in the round should be assessed as going beyond baseline with a clear framework set out ahead of time on how to assess value of going beyond baseline would be undertaken by Ofgem.

***Question 32: What are your thoughts on the size and strength of any truth telling incentive?***

We are supportive of the incentive remaining at +/- 2% of proposed allowances. It is important that this is an effective cap/collar and that a clear and transparent methodology for calculating the levels of reward or penalty being set out up front and ahead of business plan submission.

Further to this it is important that reward and penalties are reserved for companies that go beyond the benchmark or fall below a minimum threshold. For example, reward for companies in the upper quartile and penalties for those in the lower quartile. Clearly there should not be a need for all companies to receive a reward or penalty with neutral position being held for those which fall in the middle of a defined threshold.

We note that whilst the strength of the incentive was right for RIIO-2, in our view and experience of RIIO-ED2, it did not work effectively as the assessment and how companies achieved reward was not sufficiently transparent and clear enough to ensure companies could effectively assess the trade-offs of increased ambition, risk and an upfront reward. Ambiguity of incentive assessment only renders a dampening effect on incentive properties even if the ultimate level available is sufficient.

***Question 33: What are your thoughts on any alternative approaches that could be used instead of an evolved BPI?***

We have set out our views in response to OVQ28 through OVQ32.

***Question 34: What are your thoughts on the options for calculating the sharing factors and do you see strong reasons for changing the overall strength of the sharing factors relative to RIIO-2?***

Our preference is for Option 2.

Within option 2 our view is an approach similar to that of the IQI for RIIO-1 is correct given the familiarity and understanding of the approach for our sector. We are unconvinced that the approach taken for Water by Ofwat is appropriate or represents a better option than that used in RIIO-1 or RIIO-2.

In addition to this, option 3 or basing on a fixed value, has merits but “fixing the TIM sharing factors in line with their current rates, as presented in Table 4” is inherently unfair. If Ofgem are to employ a fixed sharing factor approach it needs to be done on a sector-by-sector basis and recalibrated for the price control being assessed. Fixing based on the values in table 4 effectively ‘locks in’ decisions made for a prior price control based on the information and business plans submitted for that purpose. It has the effect of penalising or rewarding companies in RIIO-3 regardless of their RIIO-3 plan qualities, based on assessments of their plans submitted for a prior period. Further, for RIIO-2, sharing factors were established using the CDIR which had flaws of perverse incentives and the potential for reducing ambition of networks. For example, we proposed two consumer driven bespoke investment proposals covering ‘Linesight’ and ‘Smart Street’. Whilst these programmes were ultimately supported by Ofgem in the Final Determination, the CDIR meant that because these were bespoke and unique our company TIM was reduced as these programmes were treated as ‘low confidence’ costs. Fixing based on this historic decision would be unfounded and mean that the sharing rate for ENWL would be lower than other DNOs without merit in the context of RIIO-3 plans.

It is in this context that fixed rates can be appropriate but should be reassessed for the RIIO-3 period and can be differentiated by sector based on the dynamics involved and the requirements of the sector in question. For example, significant investment will be required for ED coupled with the ability to assess costs more robustly through the number of sector comparators thus having more confidence in the benchmark reached means a strengthened efficiency incentive should be deployed. This would further strengthen the incentive on DNOs to innovate and deliver enhanced efficiency driving benefits to consumers and reducing the cost of necessary investment over the longer term.

## 6 Managing Uncertainty

***Question 35: Do you agree with our proposal to retain the Net Zero Re-opener with its current scope and parameters for RIIO-3?***

***Question 36: What are your views on our proposal, in principle, to retain the Net Zero and Re-opener Development Fund UIOLI for RIIO-3? What are your views on the types of projects it could fund and how it would interact with other sector specific price control mechanisms?***

***Question 37: Do you think we should retain the NZASP for GD and GT? What should its scope be and what kind of projects would you expect to be funded through this re-opener in RIIO-3?***

***Question 38: Do you have any views on consolidating the net zero related re-openers and the UIOLI allowance?***

Our response here combines the questions raised in OVQ35 through OVQ38 as these all relate to the suite of Net Zero related uncertainty mechanisms (UMs).

In summary our position in this area is:

- Remove the heat policy re-opener.
- Retain the Net Zero and Re-opener Development Fund UIOLI allowance (NZARD) and extend its application to RIIO-ED3.



- Develop a new Net Zero re-opener which is able to manage uncertainties driven by Net Zero targets and related policies, including heat policy, RESP output.
- Materiality, licensee triggers and application windows should all be reviewed and put in place accordingly to ensure the new UM is viable.
- Consider incorporating the Net Zero Pre-construction Works and Small Net Zero Projects Re-opener (NZASP) with the newly developed Net Zero Re-opener with potential ability to build in streamlined pre-construction applications.

As we reference in our response to OVQ4, we consider that the UM suite relating to Net Zero can be streamlined for simplicity. We consider that the Heat Policy Re-opener for gas can be removed, and a new Net Zero re-opener developed to enable any adjustments needed as a result of the anticipated Heat Policy decision amongst other Net Zero related uncertainties. This would be an optimal solution with any Government decision on Heat Policy and specifically hydrogen for heating in 2026 will not only affect GDNs but also DNOs and other licensees as the future of gas use will inevitably have implications for electricity use. Using a Net Zero Re-opener which would be a cross-sector mechanism is therefore a better option than having separate mechanisms for each sector.

There are a number of potential revisions to the Net Zero re-opener considered within the consultation, and we would support a full review of an appropriate mechanism that is able to accommodate changes driven by Net Zero targets and associated policies, heat policy decisions, the existing NZASP and potential changes driven by the RESP outputs. The design of this new re-opener should not be simply retro-fitted into the existing Net Zero re-opener and instead be designed based on the uncertainties it is aiming to address. Materiality, licensee triggers and application windows should all be reviewed and put in place accordingly.

With respect to the Net Zero and Re-opener Development Fund UIOLI allowance (NZARD), we note in chapter 8 that this is proposed to continue to fund small Net Zero facilitation projects and early development work in RIIO-3 for the GT, ET and GD sectors. An equivalent UIOLI allowance was not granted to ED for RIIO-ED2, meaning there is disparity between the sectors without a clear rationale for this difference. We agree that this important UIOLI allowance should continue for RIIO-3 but that this should be extended to also include ED so that all sectors and their consumers are able to benefit from this work and no consumers are unnecessarily excluded from the opportunity such a fund represents.

With respect to the Net Zero Pre-construction Works and Small Net Zero Projects Re-opener (NZASP), we consider that having multiple UMs for potentially similar purposes may cause unnecessary confusion and complexity. As this is for GD and GT companies only, we have limited awareness of how the re-opener has worked and been used, therefore have limited comments on its revision. We would add that the potential option for Ofgem of merging this with the broader Net Zero Re-opener merits further consideration and could be a way of streamlining the UMs whilst maintaining clarity on scope and purpose though this would also require the need for the mechanism to be licensee triggered. We suggest that this is explored further during cross-sector working groups. Learnings from the application of pre-construction funding (PCF) in ASTI, or how the RIIO-ED2 West Coast of Cumbria UM has been designed (to allow an application for pre-construction, followed by full submission) could be relevant areas to review here.

We note that paragraph 2.27 of the GD annex references a combined UM having an appropriate materiality threshold. Our position on materiality thresholds is that they should be considered both in the context of the sector and the nature of the uncertainty. Further, in setting any materiality threshold, the RIIO-GD3 package in the round needs to be reviewed and any common approach to materiality should not necessarily be adopted by default. In a lower return price control with

potential for more reliance on uncertainty mechanisms or specific PCDs there is naturally much less flexibility for companies to respond as they have done previously to changing environments.

We do not support applying any materiality threshold to a mandated, compliance and/or legislative requirement outside of companies' control. This has largely been applied for RIIO-2, but there are some inconsistencies which should be corrected for RIIO-3.

***Question 39: Do you agree with our proposed position to retain the Coordinated Adjustment Mechanism for RIIO-3? If it were to be retained, what design and incentive considerations could we implement to enhance the utilisation and value of this mechanism?***

We disagree with the proposed position to retain the Coordinated Adjustment Mechanism (CAM) for RIIO-3. As Ofgem recognise, it has not been used so far in RIIO-2, or in RIIO-1<sup>3</sup>, nor, to our knowledge, has it been considered for use by any licensee in the same period.

RIIO-1 was an eight-year price control and combined with the two-year timing difference between ED and other sectors meant there may have been merit in having some form of adjustment mechanism that allowed outputs, allowances, and obligations to be moved to reflect the arising benefits that another party might deliver. However, the move to have RIIO-2 and RIIO-3 as shorter five-year price control periods, combined with an increasing move towards price controls and companies' business plans having a stronger whole system focus, there is a no need for the CAM to be included in the framework for RIIO-3 and is a clear opportunity to simplify the regulatory framework for RIIO-3.

The introduction of Strategic Spatial Energy Plans (SSEP), Centralised Strategic Network Plans (CSNP) and Regional Energy Strategic Plans (RESP) for RIIO-3 also mean that the focus is greater than ever on maximising whole system planning which will then be built-in to price control settlements, and ultimately allowances, outputs and obligations. These enhancements mean that the likelihood of any output needing to be transferred from one licensee to another would be negligible and therefore the CAM is unnecessary and can be removed.

Should there be a whole system driver to make significant change that would benefit consumers across vectors, then the Net Zero Re-opener could be used instead of the CAM. A more versatile Net Zero Re-opener (as covered earlier in our response to OVQ38) could simplify the framework, whilst still ensuring that companies and Ofgem can be agile and adaptive to drive consumer benefit.

***Question 40: Do you agree with our proposal to allow physical security costs to be submitted through a broader resilience re-opener?***

We generally agree as we support the initiative of broadening the scope of re-openers for RIIO-3 with the aim of rationalising or streamlining the number of re-openers within the framework.

We note that in paragraph 8.38 Ofgem references that DESNZ is currently in the process of reviewing its physical security policy and that this is expected to result in updated guidance expected spring 2024. It is important that any outcomes of this are included within the scope of the re-opener and that the timing windows are aligned so outputs from DESNZ and the windows for re-opener applications are aligned with sufficient time for companies to develop submissions cognisant of the outputs of DESNZ requirements.

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<sup>3</sup> The CAM was introduced to RIIO-ED1 in April 2021 to align with its introduction for the RIIO-2 companies starting their RIIO-2 price control in 2021.

We also view that as this is a compliance-based re-opener it should have a zero-materiality threshold as was the Ofgem decision for RIIO-ED2. This should not be affected by the broadening or absorption of physical security costs into a single 'resilience' re-opener mechanism.

***Question 41: Do you agree with our proposed approach to introduce a resilience reopener?***

We agree given we support the initiative of broadening the scope of re-openers for RIIO-3 with the aim of rationalising or streamlining the number of re-openers within the framework.

Specifically on a resilience re-opener, we would caution limiting the scope of the re-opener to central Government decisions. There are numerous examples of decisions or requirements from other stakeholders which would fall in a resilience re-opener, such as regulators including the Environment Agency or devolved authorities. If cyber resilience is to fall under the resilience re-opener, then the ability to respond to third party threats is imperative. It is important that requirements and cost impacts that have occurred because of Government direction to other stakeholders is included in the scope and not only direct decisions from Government.

Additionally, we also view that as this is a compliance-based re-opener and therefore should have a zero-materiality threshold. This should not be affected by the broadening to a single 'resilience' re-opener mechanism as the drive is clearly and unambiguously compliance based.

***Question 42: Do you have any views on whether the opex escalator should be retained and if so, how we could evolve the opex escalator for RIIO-3?***

We agree that the opex escalator should be retained for RIIO-3. We also agree that the opex escalator should cover both closely associated indirect (CAI) costs and network operating costs (NOCs). This differs for the ED sector where the indirect scalar only considers indirect costs. We propose this position is reviewed for RIIO-ED3.

The opex escalator is an important tool to ensure that the associated costs driven by the use of uncertainty mechanisms are appropriately catered for within the overall framework.

We observe that the use of UMs has increased in RIIO-2 compared to previous price controls and therefore we support the mechanistic approach that this escalator provides (where this can be fairly and transparently set) in order to streamline the regulatory framework and avoid complexity in the re-opener/volume driver processes.

We note that the regulatory framework for ET will change for RIIO-3 to take into account the new CSNP and therefore UMs may need to change accordingly. It is also important to gain clarity on whether the ASTI still has a role for the ET sector in RIIO-3. We also note that work mix across the sectors may also vary more for RIIO-3 than for RIIO-2. It is important therefore that the overall UM package for RIIO-3, including the opex escalator, is looked at holistically to ensure it works appropriately for each sector, companies, and consumers and does not create internal conflicts or inconsistencies. The UM overall package and associated opex escalator should also clearly recognise sectoral differences.

We are not sufficiently close to the cost assessment detail and econometric analysis approach used to set the percentage uplift for these sectors and therefore have no proposals for how this could be improved or revised for RIIO-3.

***Question 43: Do you have any views on how we should effectively monitor the delivery of UMs?***

We disagree with the need to increase the monitoring of UM delivery as there is already a significant volume of reporting required in addition to as well-established assurance and governance processes as part of the existing RIIO framework.

The two options set out are effectively duplicates of the Network Data Assurance Report (NetDAR) and Data Assurance Guidance (DAG) requirements on network companies and that the regulatory levers for adjustments/ penalties are already available to Ofgem to deal with misreporting or poor-quality submissions.

Rather than considering additional options as set out in the SSMC our view is that scrutiny and how to assess 'getting it right first time' in terms of the decisions made by Ofgem is the right place to focus effort.

Upfront assessment of submissions should be where Ofgem scrutinise cost submissions including any allocation of costs. Any additional risk of in period assessment with penalties attached could see decreased appetite for innovation or alternative efficient delivery models where costs are then incurred in different areas to that in the original submission. In the case of efficiency or innovative delivery, cost being categorised differently to submission are for good reasons and to the benefit of consumers.

We would add that the proposals would also increase regulatory burden and not decrease it which should be a general aim of simplification of regulation and its framework for RIIO-3.

## 7 Cost of Service

***Question 44: Do you have any views on whether to evolve the RIIO-2 methodologies for RPEs and ongoing efficiency for RIIO-3, and if so how?***

We have split our response to this question into two parts addressing Real Price Effects (RPEs) and Ongoing Efficiencies (OEs) separately.

It is important that Ofgem considers these two areas separately and based on the merits of the information available for each in turn. Both concepts are of great importance for both consumers and companies, ensuring that cost allowances and correspondingly bills are representative of market dynamics ensuring that investment in outputs have sufficient inputs to deliver the strategic aims of the price control.

### Real Price Effects (RPEs)

We disagree with a straight roll forward of an indexation approach taken for RIIO-2. It is important that at the establishment of a price control period and its framework, time is taken to ensure that the mechanisms currently in place are fit for purpose. We have not been made aware of evidence or analysis that the current approach to RPEs is delivering for consumers and companies. We would welcome a review being undertaken by Ofgem and evidence provided to network companies.

Our experience of the application of RPEs for ED is limited given we have not yet reached our first true-up milestone though we would offer the following comments regarding practical implications of the approach taken for RIIO-ED2. We would welcome more information about how the current approach for RIIO-T2/GD2 is working being shared.

*Readily available indices*

Our experience is that the indices chosen and used by Ofgem for RIIO-ED2 are not 'public' and in some cases require a subscription to access. We have, to support our planning processes, bought these subscriptions, however, for companies or stakeholders not directly involved it reduces transparency where adjustments are made based on data not freely in the public domain. It is important that this context and learning is considered when Ofgem makes decisions around policy for RIIO-3 and the other sectors.

*True-up mechanisms cause issues of budgeting uncertainty*

An indexed approach to RPEs as moved to in RIIO-2 and RIIO-ED2 from a fixed upfront allowance in RIIO-1/ RIIO-ED1 creates issues of financial planning and annual budgeting processes. This is exacerbated in periods of extreme volatility such as the cost-of-living crisis and inflationary pressure which the UK has been experiencing. The challenge means the allowance for RPEs is largely unforecastable and therefore our ability to release RPE allowances ahead of ex-post annual true-up is removed where there is a risk of monies having to be returned in the event of an over forecast of RPE outturn. This reduces companies purchasing power meaning less outputs are able to be delivered earlier where the RPE allowance is unknown. This risks reducing or slowing down outcomes for consumers.

*Labour indexation and allowances is producing a counterintuitive inflation level*

In RIIO-ED2, broadly speaking, 63% of our costs are labour costs covering both general and specialist roles. Our experience from ED is relevant as labour markets are finite especially when considering skilled labour required by the sectors covered by RIIO-3 and RIIO-ED3. It is likely that this will come under ever increasing pressure as investment increases as we support the delivery of Net Zero as well as increasing the role of digitalisation within our sector. Currently the labour index for the RPE is negative to CPIH. This is counterintuitive in an environment of limited supply and increasing demand. Care should be given to whether the labour indices are representative of the lived experience of the sector or whether there is a lagged effect to the indices used. The ramifications of under-representing the labour element of RPEs in our industry is a reduced ability to attract and retain employees within our sector as well as a potential for increased industrial disputes in the future. Additionally, should companies offer pay increases in line with the indices used by Ofgem then this would represent a below inflation (CPIH) increase meaning real term reduction in pay for the sector more broadly. This is exacerbated when outsourced or contractor labour is considered where the cost increases are somewhat outside of the companies control and determined by the market and competition within it.

We are aware that the current operating environment may be unique in terms of its volatility and that the indexed approach used in RIIO-2 is appropriate in more traditional inflationary environments and that the issues of underfunding of indices may unwind on a lagged effect within the current period. We would suggest that alongside a review of the indices used to date Ofgem considers a UM in its framework that allows for manual RPE adjustments on top of an indexed approach in times of unique operational circumstances. We would suggest that this applies to RPEs as a whole and not individual components within it such as labour or materials.

### Ongoing Efficiency (OEs)

We agree that the OE assumption should be representative of an achievable annual reduction in the required volume of inputs that an efficient company would be able to achieve while producing a given volume of outputs.

It is important to recognise that as a construct OEs should represent incremental gains in productivity that are achievable for a company that is already operating at the efficient frontier due to technological progress, and is separate from catch-up efficiency improvements, which should not be included in the OE assumption for a given period.

It is important in this context that careful consideration is given of the calibration of OE given what this is aimed at achieving, as well as the consideration of catch-up efficiency, and what that covers. We view that within a 'traditional' assessment of OE using/utilising EU KLEMS data there are a number of key aspects which are important to consider:

- Gross output vs value-added productivity measures
- Total factor productivity vs partial productivity measures
- Time period
- Comparator benchmark sectors and weightings

We cover these in turn below.

#### *Gross output vs value-added productivity measures*

Productivity can be measured in terms of:

- **the proportion of value added to labour and capital inputs** which isolates the ease with which a company is able to convert intermediate inputs into a completed product or service; or
- **the ratio of gross output to all inputs** which tracks the way in which a final output is produced considering the full range of inputs such as capital, labour, energy, materials and services.

Use of either or both of these measures to set an OE target is valid though this must be used correctly ensuring internal consistency within the calculations. For example, if benchmarking is to the value-added productivity growth achieved by comparator companies, then the chosen benchmark must be to the value added that the energy networks themselves generate in their activities i.e. costs minus intermediate inputs. The reverse is also true, that if the benchmark is to the gross output productivity growth achieved by comparator companies, then it is logical to allow for comparable cost savings across the whole of the networks' expenditure base i.e. all controllable Totex.

It is incorrect, and cannot be justified, to mix and match value added and gross output benchmarks and apply these to the wrong cost types as set out above.

#### *Total factor productivity vs partial productivity measures*

As with value added and gross output as set out above it is important that Ofgem in assessing an OE benchmark does not misapply Total Factor Productivity (TFP) and partial productivity measures.

For example, it cannot be justified that a partial productivity benchmark such as labour productivity growth assessment can be applied to all controllable Totex. It would only be applicable to labour costs only.

#### *Time period*

Productivity growth and OE benchmarking must be estimated over complete business cycles, and an assessment over incomplete business cycles can lead to biased estimates of TFP growth.

We would note that this has been cited by Ofwat, Ofgem, CEPA and the Competition and Markets Authority (CMA) with views similar in respects of the time period to be used in assessment of productivity growth.

#### *Comparator benchmark sectors and weightings*

Only comparable sectors from the datasets should be used and appropriately weighted to reflect a fair comparison of our sectors and its input costs.

A simple unweighted assumption on each of the comparator sectors means sectors with lower or no direct comparison to network activities and costs have the OE observed from these applied on the same weighting as more relevant sectors. Weighting of the comparator sectors must be applied again to ensure that the OE target calculated reflective of the activities mix undertaken by network companies.

#### *Uplift or aiming up*

Empirical evidence to support any explicit or implicit uplift is needed. The concept of an innovation uplift when setting the overall OE target has been proposed in some form for RIIO-1 and RIIO-2 without robust and transparent evidence to support the adjustment in the calibration of an OE target. Therefore, and in line with the CMA precedent, no uplift should be given where this cannot be empirically or explicitly evidenced.

#### ***Question 45: Do you have any views on the potential application of RPEs and ongoing efficiency to re-opener applications?***

We are keen to work with Ofgem and other stakeholders as set out in the SSMC. Given there are no proposals in the document we have limited our comments to principles in response to this question.

It is important that whatever Ofgem does or does not do with regards to RPE and OE application to re-opener submissions it must be internally consistent. I.e. we would not advocate for, or see clear justification of, a differential treatment of OEs and RPEs. Therefore, Ofgem should either:

- Require companies to embed these as part of applications and assess this as part of re-opener determinations, or
- Apply the mechanisms and levels set out as part of RIIO-3 determinations for RPEs and OEs to re-openers, and companies should then submit costs gross of any adjustments for these areas.



## 8 Cyber Security

### ***Question 46: Do you agree with our proposed approach to cyber resilience in RIIO-3?***

We agree with the overall ambition to link the delivery of cyber outcomes more closely to the Cyber Assessment Framework (CAF) outcomes and use the experience gained in RIIO-2 to help reduce the regulatory burden on both Ofgem and licensees.

During the early stages of RIIO-ED2, we have found it helpful to have two re-openers already for cyber resilience projects, and we support multiple re-opener windows in RIIO-3 to ensure there is the option available for licensees if they need to propose additional investments. [REDACTED]

[REDACTED]  
[REDACTED]  
[REDACTED]  
[REDACTED]

[REDACTED] We would also support a re-opener window right at the start of RIIO-3 for adjustments to baseline allowances to account for changes to the threat landscape from submission of the Final Business Plan to the start of the new price control period.

There is merit in considering if there is a better solution than retaining the split between cyber OT plans and cyber IT plans. [REDACTED]

[REDACTED]  
[REDACTED] Further to this, Ofgem has acknowledged through their supplementary guidance to the NIS regulations that resilience can come in different forms, and so a broader scope than just IT and OT would be more appropriate. It will be of benefit to all licensees to continue to work with Ofgem to clarify the guidance and best practice for submitting re-opener applications to ensure that applications are of good quality and comparable to each other so that it makes the assessment process simpler for Ofgem.

A concern with putting the re-opener guidance into NIS guidance is that this may make it less flexible to amend at short notice if required in response to new threats. As a principle, any guidance or requirements specific to the operation of the price control should remain separate to NIS guidance, which serves a different purpose. It is important that Ofgem recognises its different roles as the economic regulator as well as the competent authority for the purposes of NIS regulations. In RIIO-ED2, the guidance has been within a stand-alone appendix document to an associated re-opener guidance document to the licence. Whilst this structure is possibly more complex than necessary, it does at least allow a specific approach to be applied to ED and is straightforward to amend as might be required. One possible way to simplify the guidance would be to make the cyber re-opener guidance document completely separate to the standard re-opener guidance associated document. This separate guidance should of course align with the NIS regulations.

The concept of a resilience re-opener is a positive development, if it allows companies to apply for funding which covers multiple areas at once, such as physical security and cyber security. We would support the establishment of more than one window over the price control period, with the ability for Ofgem to direct more windows if required by changes to legislation, the threat landscape, advancements to technology, or any other relevant factor. It is important that licensees' ability to use the resilience re-opener is not restricted to Government changes or decisions only.

We have yet to undertake PCD reporting on our cyber projects, but we already know that the level of reporting in this area is much more granular than for other areas and does not follow the RIIO-2

principles for application of PCDs. It is important that PCDs are used in a targeted way, focusing on material areas and the RIIO-ED2 threshold for bespoke PCDs of £15m is a reasonable starting point. It is sensible where PCDs are appropriate to link the PCD outcome to CAF outcomes. For cyber, the granularity and frequency of reporting differs to that required for all other PCDs. Ofgem should consider the information it receives and set PCD reporting at a proportionate level for RIIO-3, reducing regulatory burden and focusing on information which is of most applicability.

## 9 Innovation

### ***Question 47: Do you have any views on our proposal to retain a flexible allowance, providing evidence for why you think that it should, or should not be, retained?***

We welcome the proposal to retain a flexible allowance. A flexible innovation allowance provides the opportunity to be agile in response to emerging requirements and development of projects. This is particularly relevant as the pace of change associated with the energy transition is significant.

It also provides a route to enable access to funding to conduct early-stage research for new technologies or processes and the opportunity to collaborate with small-scale innovators whilst for network operators maintaining the ability to plan resource commitments effectively.

We see the provision of Network Innovation Allowance (NIA) as complementary to the Strategic Innovation Fund (SIF) as they have different focus areas. SIF investigates solutions to more strategic industry challenges whilst NIA allows networks to investigate solutions which address more specific, granular issues. Historically, we have maximised the use of our NIA as well as utilising the SIF predecessor, Network Innovation Competition (NIC) to investigate and deliver transformative industry changing solutions that are successfully deployed at scale on our network. Additionally, we committed to use both NIA and SIF in our ambitious RIIO-ED2 business plan.

The RIIO-3 proposal discusses the introduction of a revised process to check for duplication and quality. Networks have worked together to develop the Energy Networks Innovation Process which includes these checks, and we would expect any process put in place by Ofgem to complement this rather than creating additional processes which will put further burden on resources and duplicate efforts in other areas.

There appears to be a concern that there is an evidence gap in reporting of benefits. The Innovation Measurement Framework (IMF) has been introduced to capture the wider benefits from innovation, but it has only had two reporting years now and ED has not yet reported via this mechanism. We need to allow time for the process to become established and for projects to reach maturity and start to deliver benefits to understand if this evidence gap still exists. It should be noted that the ENA is continually reviewing and updating the IMF based on feedback from networks and Ofgem.

### ***Question 48: Do you have any views on our proposal to retain a competitive network innovation funding pot, that continues to focus on key challenges facing the energy sector, with phases to de-risk the pot?***

We welcome the proposal to retain a competitive network innovation funding pot. We took advantage of the predecessor competition funding (NIC), to deliver industry changing solutions and we plan to continue this with SIF.

Whilst we agree with the phased approach to manage project delivery risks, we feel that this may be better achieved by utilising stage gates rather than needing to re-apply for funding. This would reduce the uncertainty for innovators associated with moving between phases and reduce the

resource burden associated with making multiple applications. It will also allow projects to move more quickly from the Alpha to Beta phase which will reduce the overall time to reach a BAU solution.

***Question 49: Do you have any views on how the structure of the price control innovation funding could be adapted to better focus on whole systems problems, and ensure strategic alignment with other public sector initiatives?***

The SIF challenge setting process provides a method for focusing attention on particular areas of interest, like whole system problems but there are limitations in the current arrangements. The current funding arrangements are set up so that electricity customers pay for electricity-led projects and any benefits realised must flow through to the customers who provided the funding. Therefore, when we are assessing project proposals, we base decisions on electricity network benefits to ED customers. If we are to deliver truly transformative whole system projects that find solutions for whole systems problems, the funding arrangements and allocation of benefits needs to be changed to allow solutions to be developed that will benefit society as a whole.

A wider, more holistic view needs to be taken to ensure strategic alignment between energy vectors and other public sector initiatives. Firstly, the creation of a common innovation strategy for gas and electricity is needed. Secondly, the scope for accessing innovation funding should encompass the widest definition of whole system (for example including transport) and also be able to link to the Local Area Energy Plans (as defined by Local/Combined Authorities) and Regional Whole Strategic Plans (as defined by the Regional Energy Strategy Planner). Thirdly, there should be better alignment between GD, ED, ET and GT innovation outputs, allowances and reporting on benefits within the same price control period.

***Question 50: Do you agree with our proposal to continue with a similar level of innovation funding, and if not, could you provide evidence for why a different amount is required, including consumer research you are aware of into their willingness to pay for network innovation?***

We agree with the proposal to continue with a similar level of innovation funding but would welcome the opportunity to “re-open” the conversation if there were policy changes which would necessitate increased investment in innovation.

***Question 51: Do you agree there is a need to expand the scope of innovation funding to be more inclusive of third parties?***

We continue to support innovators to develop ideas and have a strong track record of collaboration resulting in deployed solutions, such as Bidoyng<sup>4</sup>, Weezap<sup>5</sup>, Low-Cost Earth Fault Detectors<sup>6</sup> and new forecasting techniques which are used by all networks.

A pre-requisite of NIA funding is that 75% of the allowance must be spent with third parties. In the majority of projects, the third party is not listed as a “project partner” as they are not providing a financial contribution to the project which is the definition of a project partner. We see the

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<sup>4</sup><https://www.enwl.co.uk/future-energy/innovation/smaller-projects/low-carbon-networks-fund/the-bidoynng-smart-fuse/>

<sup>5</sup><https://www.enwl.co.uk/future-energy/innovation/smaller-projects/low-carbon-networks-fund/low-voltage-protection-and-communications-lv-pac/>

<sup>6</sup><https://www.enwl.co.uk/future-energy/innovation/smaller-projects/network-innovation-allowance/enwl007--reliable-low-cost-earth-fault-detection-for-radial-overhead-line-systems/>

requirement to provide a financial contribution as the main barrier to partnering rather than the perceived barrier of IPR.

There can be a number of reasons why networks might be perceived as a blocker to third party ideas and solutions. There are many legitimate reasons which may cause us not to progress third party ideas such as:

- it does not provide a benefit for all GB consumers, for example it only has a limited application,
- it is not truly innovative from a network perspective, for example if they are proposing a new storage technology, networks already understand the benefits of storage and are technology agnostic, so it is not effective use of customers money to trial a new technology,
- it is a behind the meter solution which cannot be owned / managed by networks. Explaining the roles and responsibilities for all involved in the energy system transition would help innovators to understand who is best suited to support their idea,
- it does not solve problems on our network,
- the proposed solution will not comply with network safety requirements, and
- we do not have the resource capacity (or funding) to support the solution development.

***Question 52: What are your views on us establishing an accelerator to support early stage innovators?***

We have not seen a problem with early-stage innovators struggling to be involved but do not object to an accelerator being established, as long as rules are put into place detailing the types of innovation that could be supported. This is to ensure that we only support innovations that are suitable for GB networks and can provide benefits for consumers and not those which exclusively fund development of a third party's business.

It is unclear as to how an accelerator such as this differs from the SIF Discovery phase challenge and triage process and so we would welcome further details on how accelerators would operate from Ofgem to clarify this.

Considering the SIF programme specifically we find that the compact nature of the timing of the challenge setting, pitching and applications does not allow enough time to fully develop significant numbers of third-party proposals into a format that is likely to be successful in securing funding. Networks need to be selective on which proposals we progress to ensure we use resources economically and efficiently and optimise value for consumers.

***Question 53: What are your views on our proposal for this to be a smaller part of a future challenge fund and to be sponsored by networks?***

An accelerator of this nature funded by consumers should be considered very carefully by Ofgem, as the focus of early-stage innovators implies risk and the appropriate amount of consumers' money to be exposed to high levels of risk needs to be closely examined. There are other sources of funding already available to innovators but, if the accelerator is to go ahead and be funded from the competition fund, we would expect that the funding pot is increased accordingly and there is no detriment to the types and numbers of SIF projects funded.

We do have concerns regarding resourcing in assessing applications to the accelerator and supporting innovators in the development of their proposals. It is unclear whether networks will be expected to provide this resource. If this is the case, establishing the accelerator will place significant

resource burden on already stretched innovation teams. We also have concerns around the management of intellectual property, as networks do not have the appropriate skills or resource.

***Question 54: Do you have evidence of potential innovation projects that have not been implemented or sought funding due to the five-year structure of the price control? How could this issue be addressed?***

The current approach to innovation funding can lead to a “ramp down / ramp up” of innovation either side of the price control change. Until there is certainty of funding, networks are unlikely to start new projects which results in structuring projects to finish before the end of the price control. Potential changes to governance and reporting that comes with a price control change adds to the uncertainties.

Innovation funding only covers development to Technology Readiness Level (TRL) 8, the development required to take the solution to TRL 9 and ready for rollout must be funded by networks. Additionally, new innovative technologies are normally more expensive whilst their use is still in its infancy and a market not firmly established, therefore deployment of these solutions could potentially cost more than traditional methods for the same benefit. Given these considerations, networks are likely to favour implementing projects that can deliver a benefit within the price control and allow them to recover some, or all, of the final development and deployment costs.

The current innovation funding programmes do not significantly incentivise licensees to propose projects that benefit consumers, rather the benefit must be to the network and consequentially to consumers. An example of this is Smart Street which proved that, by using active voltage control on low voltage networks, energy consumption can be reduced to deliver savings on consumer bills.

Mechanisms such as the SIF Beta phase (and the NIC) are not bound by the five-year structure and can run over price controls as the funding is project specific and managed separately from the main business funding.

***Question 55: Do you agree with our proposal to run FRS trials with an explicit focus on informing changes to the rules governing energy network activities – incentivised through SIF or other price control mechanisms?***

The use of FRS needs to be considered on a case-by-case basis as well as being used in a controlled way to reduce the impact of unintended consequences. This should be considered in the context of the energy system as a whole with an integrated gas and electricity system and not just gas or electricity in isolation, as impacts in one sector can easily be felt by consumers in another sector.

We strongly agree that Ofgem should consult before the FRS is used for each case, setting out the justification clearly so that it can be reviewed by the industry and the consequences properly and openly considered. The consultation should include the detailed assessment undertaken Ofgem ahead of deployment including the costs, benefits and impacts that are likely to occur.

It is also important that consideration is given to how any FRS initiative might affect network and industry codes and how the respective code managers should be involved in the process.

There is still value in using built-in innovation in price controls. Regulatory innovation does occur when price controls are set. One relevant example of this is our Dig, Fix & Go bespoke financial incentive. This was developed and included in our RIIO-ED2 business plan based on direct customer and stakeholder feedback received and is already delivering benefits to consumers having been included in our Final Determination from Ofgem. The FRS could be useful in allowing similar

innovation projects or incentives to be introduced part-way through a price control period, or for a period that stretches over more than one price control period if necessary.

***Question 56. What topics could FRS trials usefully focus on and why?***

We have no specific examples of topics for FRS trials however, our position is that the FRS should only be used for brand new innovations, and not for experimenting with changes to existing policies and/or processes. It should only be used for new emerging areas of regulation with the focus on trialling of regulatory models or innovations to meet these new challenges. Existing areas of regulation and innovation should, by definition, be out of scope of the FRS.

***Question 57: Do you have any feedback on the view that not enough network innovation funded projects have been rolled out, and can you share any evidence you have to support your position?***

Since the inception of network innovation funding, we have rolled out a significant number of new solutions and processes developed as part of the mechanisms.

Our small-scale projects have produced fault and network management solutions such as Bidoyng<sup>7</sup>, Weezap<sup>8</sup> and Low Cost Earth Fault Detectors<sup>9</sup> which are widely used by all networks as well as developing and implementing innovative asset management techniques, such as oil regeneration which can extend the life of transformers.

Our NIA portfolio has also produced new forecasting and investment optimisation techniques which are used to ensure that we invest in the right areas and at the right time. These types of projects do not result in a solution to roll out and as they cannot be quantified have been effectively hidden from benefits reporting.

By its nature innovation is uncertain and it can take time to develop a solution which is suitable for implementation in business as usual. Therefore, we have a number of projects which have developed solutions ahead of the expected increased installation of low carbon technologies and therefore have not been rolled out yet.

We have used our NIA portfolio to conduct early stage research for our larger NIC demonstration projects. For example, learning taken from four smaller NIA projects was brought together in the Smart Street demonstration project.

Our NIC portfolio has delivered industry changing solutions such as CLASS and Smart Street. CLASS is fully embedded across our area, providing balancing services multiple times each day and delivering benefits for consumers. An Impact Assessment conducted by Ofgem in 2022 quantified the net benefits from CLASS as £883m over 30 years for a GB wide rollout.

During RIIO-ED1, we rolled out Smart Street to a limited number of sites and in RIIO-ED2 we will be expanding this rollout to include a further 1000 sites which is expected to deliver benefits of £456m over its lifetime (out to 2076) as identified in our RIIO-ED2 analysis.

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<sup>7</sup><https://www.enwl.co.uk/future-energy/innovation/smaller-projects/low-carbon-networks-fund/the-bidoyng-smart-fuse/>

<sup>8</sup><https://www.enwl.co.uk/future-energy/innovation/smaller-projects/low-carbon-networks-fund/low-voltage-protection-and-communications-lv-pac/>

<sup>9</sup><https://www.enwl.co.uk/future-energy/innovation/smaller-projects/network-innovation-allowance/enwl007--reliable-low-cost-earth-fault-detection-for-radial-overhead-line-systems/>



***Question 58: What are your views on the design of potential new mechanisms to address this?***

Previous price controls included an Innovation Rollout Mechanism (IRM), and we would welcome the re-introduction of a similar mechanism.

In RIIO-ED1, we successfully applied to the IRM to fund a limited roll out of the Smart Street solution. As described in our response to OVQ54 there was no network driver to deploy Smart Street during RIIO-ED1 but we were aware of the significant benefits it could provide our consumers. The IRM funding allowed us to start roll out ahead of RIIO-ED2 and gave us further evidence for a larger scale roll out during RIIO-ED2.

## 10 Data and Digitalisation

***Question 59: Do you have any views on the timelines for modernising regulatory reporting?***

In the realm of Data and Digitalisation generally, we would support more urgency on discussing Artificial Intelligence (AI) and its potential impact on the energy industry as a whole. It is clearly a rapidly growing area which should receive a greater level of scrutiny. AI offers opportunities in both aiding licensees with business as usual (BAU) activities, as well as game changing areas which have not been fully examined, which may help to improve the operation of the network and the level of service provided to consumers.

We have seen in the published Ofgem forward work programme that there is a forthcoming consultation on AI. We believe it is important that cross-sector work to set the rules and ethical standards around AI starts, as the use of AI by licensees will likely accelerate as companies look to harness the potential of this powerful new technology. Additionally, licensees should be prepared to strengthen their cyber resilience capabilities to resist threats from cyber AI. As hostile entities start to make use of AI, licensees will need to respond at pace to new threats developed through AI.

***Question 60: Do you have any initial views on opportunities for improving efficiency in providing the data that Ofgem receives as part of regulatory instructions and guidance?***

*General observations on RIGs reporting*

We would like to see a thorough review of the data provided for disaggregated analysis to ensure that it is fit for purpose. We would hope that this would result in an improvement in the quality of the data collected rather than an increase in the volumes collected. There may even be scope for a reduction in the regulatory reporting burden. We see a significant benefit of Ofgem reviewing collected RRP data when it is received, including asking relevant questions, undertaking comparisons between companies of the data submitted and then driving consistency in datasets on a continual basis. This would render the data collected as more consistent and improve its use as inputs to future price controls.

The main opportunities for making regulatory reporting more efficient and quicker will be focusing on what data is most useful to exchange, and in designing the system to maximise the ability to quickly compare and analyse the data received.

The plans to develop a new data sharing infrastructure will potentially make the process of receiving data by Ofgem quicker and easier but is unlikely to save licensees any time or resources required to undertake regulatory reporting.



A key consideration is that making the exchange of data more efficient will not make the regulatory reporting process quicker for licensees because all the data to be submitted to Ofgem will still need to go through the usual rigorous review and sign off processes required under licence obligations, which can take many weeks. This, coupled with the sheer volume of data required to be shared means that regulatory reporting will remain a lengthy, time-consuming and heavily resource-intensive process, unless the volume of data is significantly rationalised and reduced. The start of a new price control period is the best opportunity available for Ofgem to review what data it collects, which data it has and has not used over the course of the period and decide which unused data no longer needs to be collected from licensees. The real benefits and efficiencies will be realised by removing the requirement to collect, review and process large amounts of data into reporting templates. To achieve this, there needs to be more discussion on the most appropriate level of detail for regulatory reporting, especially as the annual reports published by Ofgem on licensee performance uses a very small subset of the data submitted by licensees every year. Reducing the level of detail will reduce the overall amount of time required to collate the data.

One specific way to make analysis easier is for licensees to be able to submit their data in a structured format which allows it to be reviewed and signed off easily. The system could then convert the data into a flat file which could be made available to relevant parties to allow them to undertake their own automated/programmable analysis quickly.

***Question 61: Are there areas of regulatory reporting that would be most beneficial to start with in the modernising project?***

It would be helpful to automate any data extraction from standard systems used by all companies. For example, in the ED sector specifically, the area where there is most consistency amongst DNOs is for 'Annex F – Interruptions' which is based on a clearly structured database. All DNOs use their NaFIRS database as the basis for their returns. If DNOs were to upload extracts from the NaFIRS database directly to an Ofgem platform then those explanatory summaries could be calculated in Ofgem systems, enabling more efficient analysis.