

ENERGY NETWORKS ASSOCIATION RESPONSE TO RIIO-2 OPEN LETTER

Energy Networks Association (ENA) represents the “wires and pipes” transmission and distribution network operators for gas and electricity in the UK and Ireland. As private companies providing a public service, our members are responsible for the critical national infrastructure that delivers these vital services into customers’ homes and businesses.

Introduction

1. ENA members welcome the opportunity to respond to Ofgem’s Open Letter on the RIIO-2 Framework. For ease of comprehension our response is aligned with the structure of the Open Letter consistent with the five themes, under which it sets out a number of observations and questions.
 - 1.1 Within our response we have sought to set out the collective views of our members. Our response therefore sets out a number of key common principles and points on which there is broad agreement between ENA members and responds to a number of the specific issues identified within the letter and associated questions.
 - 1.2 ENA members are proud of their role as private companies providing a public service. Regular satisfaction surveys conducted by Ofgem with a range of customers show consistent satisfaction of more than 80% in the services provided by network companies, putting networks above any energy supply company, higher than many high-street retailers and amongst the very best performers in the UK Customer Satisfaction Index.
 - 1.3 With that in mind, in our response there are three key proposals that we believe Ofgem should focus on to deliver enhanced benefits to the end-energy user which will also have a wider systemic benefit:

Engaging the end-consumer: Ofgem should consider the establishment of panels that represent end-consumers interests that will operate over the course of the next price controls; these panels could help inform the assessment of RIIO-2 business plans and through evaluation of RIIO-1 identify approaches that have delivered outstanding results and how these may be further developed and adopted recognising cross-sector and regional differences. These regional differences will require ENA members to undertake their own programmes of engagement to demonstrate their business plans are legitimate in the eyes of their stakeholders by delivering their desired outcomes and representing value to consumers.

Ensuring transparency: We believe that Ofgem should undertake a review of reporting requirements in terms of what aspects of the network’s business is being reported against and the level of detail required. Part of this assessment should be

whether and how the reported information is being utilised and whether there is scope for simplification, rationalisation or re-prioritisation.

Delivering innovation: It is imperative that innovation in networks continues to be strongly incentivised under future prices controls. The RIIO innovation stimulus has had significant success in encouraging network companies to bring forward innovative projects and embed a culture of innovation within their organisations. This has led to significant advances in the application of new technologies and techniques and the development of skills and capability within the organisations involved, to the benefit of current and future consumers. Indeed a key feature of the RIIO-1 innovation mechanisms has been the collaboration and sharing of best practice delivering both short term benefits shared with the customers of the innovating network and subsequent longer term customer benefits across all networks. New approaches, including the development of whole systems incentives designed to drive innovation, used in combination with current type innovation support measures may also provide an attractive option, helping to deliver the energy system we will need in the future.

RIIO-1

2. RIIO was intended to drive improvements in network performance, foster innovation, encourage engagement with stakeholders and reduce customer bills. The latest evidence from the annual reports is that network companies are rising to the challenge and that the framework is enabling networks to deliver the intentions behind RIIO. Across transmission and distribution, networks have performed strongly against key outputs for reliability, safety, customer satisfaction and the environment.
 - 2.1 In the electricity networks power cut occurrence fell by 9% last year with a reduction of 50% over the last fifteen year period. Distribution Network Operators (DNOs) delivered a reduction in the length of time to connect customers to the electricity network, accommodating rapidly increasing demand from renewable generators. Delivered a 25% reduction in the number of supply interruptions that customers experience, a 40% reduction in the duration of supply interruption, reduced the average domestic customer bill by 5.5% (since 2013) and reduced the number of safety incidents to an all-time low across the industry. Electricity transmission reliability continues to be greater than 99.9999%, with energy not supplied significantly less than targets over the last 5 years.
 - 2.2 Similarly, the reliability of the gas network has continued to improve, to a level of 99.998% where customer supplies are interrupted on average only once every 40 years. The iron mains replacement programme has removed significant levels of risk from gas distribution, GDNs are delivering strong safety outputs and are leading across multiple sectors on Customer Safeguarding. Their CO awareness programmes have saved lives, and they have delivered 40,000 fuel poor connections in the first three years of RIIO-GD1, giving low income and vulnerable households'

access to a reliable and affordable source of heat. The certainty provided by, and the greater opportunity for companies to innovate within, an eight year RIIO-GD-1 price control has enabled GDNs to deliver forecast reductions of around 12% in controllable costs against allowances and 9% in customer bills in real terms over the period.

- 2.3 All network sectors continue to deliver customer satisfaction scores that would be the envy of virtually any other industry or company.

Decarbonisation & Innovation

3. Decarbonisation is changing our energy system rapidly and the way in which energy is produced, supplied and consumed is very different from only a few years ago. The pace of change we are seeing in the energy sector is set to accelerate as take up of new technologies such as smart meters, energy storage, green gas and potentially hydrogen increases while consumers are seeing greater choice and control over the way in which they to use energy.
 - 3.1 Innovation is at the heart of the transformation of our networks, driven by the need to adapt to the challenges associated with decarbonisation and to use new technologies to help continue to deliver secure and affordable energy in a low carbon future. In recent years our networks have become the most innovative part of the energy industry, not only in the way our existing networks are most efficiently and effectively utilised, but in the frameworks under which they are regulated and as a platform for the testing and integration of new technologies. This has helped to place the UK as a world leader in the development of smart low carbon networks of the future and as a catalyst for the development of products, know-how and capability that will enable the UK to capture an increasing share of emerging global markets for these smart, low carbon products and services. Under the RIIO framework innovation projects are taking place across all gas and electricity price controls and smart network, low carbon solutions are already being rolled into 'business as usual' for companies and delivering cost savings for customers.
 - 3.2 Innovation in the gas and electricity network sectors is facilitating the rapid connection of renewable sources of electricity and low carbon gas, continuing to underpin the UK economy and enable low carbon growth in a sustainable energy future. Innovation in smarter low carbon networks can deliver new opportunities for economic growth and employment across all regions of the UK. Economic potential associated with electricity smart grids alone is estimated at £13 billion of Gross Value Added, £5 billion of potential exports to 2050 and 8,000 – 9,000 jobs over the 2020s and 2030s¹.

¹ DECC, 'Delivering UK Energy Investment: Networks' (2015)

- 3.3 It is becoming increasingly recognised that our gas networks have a key long term role to support the decarbonisation of the economy. Currently gas generates around half of our average electricity demand and up to 80% at times of peak demand. Gas network companies are pioneering new decarbonised gas technologies to help meet low carbon heat demand, power generation and growing use of gas in transport. The potential for biomethane, BioSNG and Hydrogen to be delivered through our extensive gas network infrastructure is increasingly seen as the most technically and economically feasible way to overcome the significant challenge of decarbonising heat. Over 80 sites in the UK are injecting green gas into the distribution network, already contributing more than 2.5TWh to domestic gas production². It also presents an opportunity to make the UK a world leader in these sectors, drive growth across the whole country, tackle societal challenges such as decarbonising heat and heavy goods transport, and find more environmentally responsible solutions for waste.
- 3.4 The UK is well placed to become a world leader in these increasingly important fields if the correct regulatory and policy frameworks are implemented.

Electricity Networks

- 3.5 The Open Networks project³ is responsible for proposing solutions to the change in roles and responsibilities of electricity networks that come about as a result of the widespread availability and adaptation of new energy technologies, such as distributed generation, storage and flexibility services. At the heart of this work is the transition of local electricity grids from the traditional Distribution Network Operator (DNO) model to an enhanced Distribution System Operator (DSO) model, with far greater capability to manage the impact of new energy technologies at a local level.
- 3.6 Alongside this, it is necessary to develop enhanced ways of working between distribution and transmission, so that the enhanced DSO model can work with the National Grid as the transmission System Operator to drive efficient whole-system solutions to network challenges; and promote efficient outcomes for consumers. The Open Networks project is based around four work streams:
- DNO to DSO transition: defining the DSO transition.
 - T-D Process: exploring challenges at the interface between transmission and distribution networks as roles and responsibilities evolve.
 - Charging: reviewing the charging requirements of enduring electricity transmission and distribution systems.
 - Customer Experience: considering the customer experience as we accelerate the move towards a more flexible energy system.

² <https://www.gov.uk/government/statistics/rhi-deployment-data-february-2017>

³ <http://www.energynetworks.org/electricity/futures/open-networks-project/open-networks-project-overview/>

- 3.7 Whilst the high level principle of the DSO transition has come to be well understood within the industry, there is a wide range of activity that could fall within its definition, and understanding what that role will entail is a vital prerequisite to delivering the transition. The Open Networks project's definition of the DSO transition, seeks to satisfy four key principles:
- That a DSO is non-discriminatory and technology neutral: favouring solutions that provide the most optimal solutions rather than particular technologies;
 - That it uses market mechanisms that are fair, transparent and competitive, providing a level playing field for providers of network services and providers of energy products/services in order to deploy the most efficient and effective solutions;
 - That it supports flexibility and innovation in responding to customer future requirements and in developing the network services they require, including enabling and facilitating innovation by others; and
 - That it delivers value and service to a range of customers and communities.
- 3.8 The Project also aims to build on the lessons learnt by network companies from innovation projects undertaken through previous price controls. It brings together the leading minds in the UK energy industry to transform the way our networks work - all 8 of the UK's electricity network operators (including National Grid as the System Operator), the Department for Business, Energy & Industrial Strategy and the energy regulator Ofgem, as well as leading academics, trade associations and NGOs.

Gas Networks

- 3.9 The RIIO-2 framework must recognise the most plausible future pathways currently being explored all involve a continuing vital role for the gas network. A priority should be to provide a platform for innovation to unlock the significant opportunities that exist to decarbonise the gas network during RIIO-2. Decarbonising gas will help deliver emissions reductions across the energy system, as well as supporting industrial opportunities and economic growth more widely. It has an important role to play in heating decarbonisation, where progress towards emissions targets has stalled. In addition, the inherent gas stored in the networks provides an economic energy storage option, allowing the electricity industry to decarbonise through accommodation of increased intermittent renewable output.
- 3.10 This means that frameworks need to support ongoing decarbonisation efforts, along with longer-term investment in network preparedness and innovation. As the Committee on Climate Change said in their 2016 report on "Next Steps for UK Heat Policy", Ofgem need "to ensure RIIO framework reflects a range of future gas options" through the 2020s. In particular, the CCC called for support for low-regrets options such as supporting increased biomethane supply, and "preparatory action, including R&D and pilots", on options like Hydrogen.

- 3.11 Network companies have been quick to respond to these changing demands and innovate to remove barriers and facilitate investment in and take-up of low-carbon solutions. But the pace of change can be expected to hasten over the next decade and beyond, bringing unprecedented challenges in the way in which we design, operate and manage our gas and electricity networks.
- 3.12 Investment needs to be maintained on the distribution and transmission system during RIIO-2 to enable green gas and potentially hydrogen to play a crucial role in the decarbonisation of energy networks. Crucially this investment will also maintain and improve the safety of gas transportation as well as enable the multi-use of gas networks, for example the use of CNG for vehicle fuel.
- 3.13 ENA members believe meeting these future challenges and maximising the contribution energy networks can make to clean growth will require greater co-ordination, one where industry, government and regulator share a common vision and shared responsibility with the aim of delivering outcomes for the benefit of consumers and the contribution that will make to a successful UK economy and wider societal good. In setting the regulatory framework for RIIO2 we therefore believe there needs to be a clear and explicit recognition of the future long-term role of both the gas and electricity networks in delivering government's wider energy and industrial policy agenda and a sustainable future.
- 3.14 Against this background of rapid but uncertain transformation of our energy system regulatory frameworks will need to offer stability and certainty to network companies and their investors if they are to deliver the best outcomes for consumers in the form of reliable and safe networks that deliver value for money services that consumers want and need. Generally our members are of the view that the RIIO framework provides a proven performance based framework to which consumers are central, has successfully encouraged early innovation and for the most part is adaptable to future challenges and the need to put consumers first.

The following sections respond to the issues set out under each of the five themes and draw attention to a number of potential opportunities to enhance and improve the framework for the overall benefit of consumers.

Objective for RIIO-2

4. Our members acknowledge the rationale behind the proposed overarching objective for RIIO-2 and how Ofgem intends to achieve it. However, we draw Ofgem's attention to the need for RIIO-2 to explicitly recognise and be complementary to the Government's wider policy objectives of delivering secure, affordable energy and clean growth, the three elements of the energy trilemma. The Infrastructure and Projects Authority, in the National Infrastructure Delivery Plan 2016-2021 to the UK Government, state that in the current Parliament and beyond there is an unprecedented investment challenge to maintain a reliable, secure network, and deal

with changes in demand and generation that will occur in a low carbon future. The report goes on to state that RIIO is designed to help ensure this is delivered at a fair price for consumers.

- 4.1 We would encourage Ofgem to remain open to further development of the stated approaches and consider whether they should be more explicit on the questions of managing uncertainty, innovation in its wider interpretation i.e. innovation funding mechanisms and incentives, and the assurance of a proportionate, stable and predictable regulatory regime.
- 4.2 The approaches adopted under RIIO-1 have driven significant improvements for customers across both electricity and gas networks and provide a strong platform to evolve the regulation of networks under the RIIO-2 framework.

Key Principles for the Framework Review

Giving consumers a stronger voice in setting outputs, shaping and assessing business plans.

- 5. Under RIIO-1 we have seen significant improvements in networks with greater focus on customers and greater stakeholder engagement. Evidence shows that stakeholder engagement under RIIO-1 has generally worked well and provides a sound basis for network companies to build upon under RIIO-2. Going forward our members believe that new approaches can be developed that will provide greater focus on and engagement with end consumers, strengthening their voice in the development of business plans and price control decisions and beyond.
- 5.1 Engagement needs to be consistent over the full period of the price control, with various approaches utilised e.g. direct engagement with end consumers using both quantitative & qualitative methods; programmes of research and panels & fora. Developing an understanding of customer groups and their wants and needs, including where these may change, is critical to delivering further improvements in customer experience over the price control period. Learning and understanding from these engagement activities will be important inputs to how network companies structure and operate the various aspects of their business in order to enhance the customer experience. This includes communicating to consumers how their feedback has been acted upon and the resultant benefits to them.
- 5.2 Ofgem should consider the establishment of panels that represent end-consumers interests that will operate over the course of the next price control; these panels could help inform the assessment of RIIO-2 business plans and through evaluation of RIIO-1 identify approaches that have delivered outstanding results and how these may be further developed and adopted recognising cross-sector and regional differences. These regional differences will require ENA members to undertake their

own programmes of engagement to demonstrate their business plans are legitimate in the eyes of their stakeholders by delivering their desired outcomes and representing value to consumers. Any approach to stakeholder engagement should be comprehensive and inclusive of the wide range of stakeholders, including end-consumers (households and businesses), network users (generators and suppliers), interest groups and local authorities.

- 5.3 **Outputs:** Our members recognise the benefits of an output based approach and generally the structured approach currently applied with a focus on delivering desired consumer outcomes and resultant consumer benefits. Under RIIO-1 output measures did generally target the right behaviours and provide the right degree of clarity around delivery, also leaving scope for innovation.
- 5.4 Looking ahead and against the backdrop of a rapidly changing energy sector there may be a need for some output categories and related incentives to change. Flexibility may be needed to allow network companies to innovate in order to develop and deliver optimal solutions which deliver maximum benefit to consumers, so outcome based mechanisms should be considered in some areas. In addition, we believe that moving into RIIO-2 there may be scope for simplifying outputs and secondary deliverables such that they are more meaningful in terms of outcomes experienced by customers. There is scope for new outputs, for example, related to the transition to a Distribution System Operator (DSO) role and/or perhaps around delivering wider ‘whole system’ approaches to network planning and operation. In this respect the Electricity System Operator (ESO) as an entirely new legal entity will also require clearly defined outputs (see paragraph 9.4).

Allowing regulated companies to earn returns that are fair and represent good value for consumers, properly reflecting the risks faced in these businesses, and prevailing financial market conditions.

- 6.1 **Financial:** At this relatively early stage of the review process our members believe that no significant changes to the RIIO framework are required in order to better facilitate returns that are demonstrably good value for money for consumers. To allow the regulator to achieve the necessary balance of risk between customers and investors and the level of achievable returns we expect that the existing RIIO ‘toolkit’ will need to evolve in response to the fundamental changes we are seeing across our networks, the integration of learning under RIIO1 and the wider regulatory environment. Customer engagement with clear performance measures is key to demonstrating that the services provided by gas and electricity networks offer value for money, reflected in both world leading levels of services performance i.e. safety and reliability and achieved costs efficiencies reflected in downward trending charges over the current price control.

- 6.2 Our members believe there are a number of potential areas and approaches for reducing risk of forecasting errors. Guidance issued by Ofgem on forecasting should be clear and understandable with scope for misinterpretation minimised. Forecasting should wherever possible utilise 'real' data. Indexation of certain cost elements can in theory enable current market conditions to be more closely tracked and there is the option of simply passing through actual costs. However, the allocation of risk between the consumer and the network companies should be carefully considered and these types of approaches may not necessarily work in the best interest of customers. Approaches such as the use of the Information Quality Incentive (IQI), Totex Incentive Mechanism (TIM) and benchmarking when used in combination all work to deliver a fair allocation of risk associated with forecasting errors.
- 6.3 There may also be other options that help minimise forecasting error such as the timing of price controls and submission of business plans and use of uncertainty mechanisms such as re-openers and volume drivers.
- 6.4 As a principle, the levels of achievable returns should directly reflect the performance of companies with performance levels across companies resulting in distinguishable levels of returns. This can be fairly and effectively delivered through appropriate setting of the mechanisms and incentives within the price control. However a key regulatory principle that needs to be adhered to going forward is that a fair return is when an efficient company earns its cost of capital, with outperformance incentivised and underperformance penalised, relative to price control targets for costs and outcomes. Seeking to artificially cap returns either explicitly or via the setting of an unrealistic calibration of the financial and incentive parameters risks reducing investor confidence and/or increasing investment risk with a resultant increase in the cost of capital and would not be in the long-term interest of consumers.
- 6.5 Transparency is central to evidencing the legitimacy of returns both in terms of reporting performance, for example, through the RIIO reporting process and through interactions with customers where service levels and improvements can be clearly demonstrated and communicated in a way that directly relates to the needs and wants of customers, particularly end-consumers.
- 6.6 **Cost of Capital:** Setting the cost of capital for the next price control is a complex matter in this environment of abnormally low yields and central bank quantitative easing which may soon end. Our members acknowledge the study commissioned by UKRN that will inform decisions on this aspect of the RIIO-2 framework. Whilst it is important that the different elements of the WACC are set correctly, these should not be determined in isolation of each other and should be considered in the context of the overall financial package and delivering healthy capitalisation of the network companies. In this respect the political environment including Brexit should to be factored.

- 6.7 **Indexation:** Indexation has a role to play in the price control framework and there are a number of possible approaches for indexation to which the choice of indices and period over which they are applied is critical. Of the areas outlined by Ofgem we believe the cost of debt is a more fruitful area to explore than indexation of the cost of equity. Whilst certain approaches may deliver greater correlation to current market conditions any approach needs to take account of both new and embedded debt, such that allowances adequately fund debt incurred under previous price controls and market rates.
- 6.8 Overall it is not clear that greater indexation of the WACC elements will deliver net benefits to consumers over the longer-term and may simply introduce greater volatility and risk.
- 6.9 CPIH should not be seen as the default option. Any change needs to be considered very carefully from both a consumer and investor perspective and ensure that present value neutrality would be achieved in a transparent manner. It should be recognised that significant long term capital has been invested based on RPI expectations, before CPIH gained (official recognition), and the market for CPI linked funding remains much less liquid than RPI linked funding.

Incentivising companies to drive consumer value by shaping or proactively responding to changes in how networks are used and services are delivered.

7. **Aligning Electricity Price Controls:** Given the positive drivers for moving to a whole system approach; the increasing interactions between gas and electricity networks and transmission and distribution levels; and the work that is currently underway through ENA's Open Networks project to deliver the transition to a smart flexible network, our members recognise that there may be potential advantages and consumer benefits from greater alignment.
- 7.1 Intuitively, greater alignment might be expected to enable the benefits of a whole system and 'smarter' approach to be more readily realised, for example, future network planning and investment conducted in a co-ordinated way; future ongoing day to day 'smart' co-operation and coordination needed between the transmission and distribution companies with potentially greater alignment of incentives. However, there may also be downsides to such an approach, for example, it is likely to place significantly increased resourcing demands on Ofgem, network companies and stakeholders with associated risks.
- 7.2 Therefore, whilst there is merit in considering this option further, a thorough analysis of the costs, benefits and risks associated with any change to the current sequencing of electricity price controls would be required. Fundamental to any future decision by Ofgem on this question is recognition of the legitimate expectations of investors, the

business planning periods over which they have invested and future investor confidence in the regulatory framework and decision making process.

- 7.3 **Smart Alternatives for Gas & Electricity Network investment:** Generally the current framework supports the use of smart alternatives to traditional investment. Equally the efficiency incentive for smart approaches should mirror that for traditional solutions. In designing and implementing smart solutions Ofgem may wish to consider allowing approaches that have the potential to deliver greater benefits over the medium to longer-term in return for an incremental increase in cost and risk of part-stranding, with companies fully remunerated for their costs. Whilst smart solutions can deliver overall efficiencies compared to traditional investment the structure of costs in terms of increased design, planning and ongoing operational costs for smart solutions should be recognised, albeit Totex supports smart type approaches. Ofgem should ensure that the framework allows a whole systems approach which considers smart alternatives across and the interactions between both gas and electricity networks to deliver best value for consumers.
- 7.4 **Asset Stranding:** In some respects there is a significant degree of uncertainty as to the future demands that will be placed on our networks in terms of the expected growth in low-carbon and conventional generation and demand through things such as increased penetration of electric vehicles. On the other hand the policy, legal and regulatory frameworks set by previous and existing government, for example the Climate Change Act, provides a clear indicator of the direction of travel and the need to substantially decarbonise our energy systems.
- 7.5 Networks need to be the neutral facilitator and enabler of the changes needed to our energy system. RIIO-2 needs to take a 'least regrets approach' to efficient investment in networks in order to avoid networks slowing down or blocking decarbonisation. Greater focus and consideration should also be given to the future role of existing gas network assets and the crucial role they can play in delivering our energy and decarbonisation objectives at lowest cost and at least disruption for customers.

Using the regulatory framework, or competition where appropriate, to drive innovation and efficiency.

8. **Assessment of Business Plans:** Our members welcome the retention of the toolkit approach used under RIIO-1 for assessing efficient costs. The provision by Ofgem of guidance that gives greater clarity on the ways in which business plans will be assessed ahead of their submission will assist the assessment process.
- 8.1 Historic company performance should be considered against business plans but is just one set of indicators that whilst useful will not be predictive of the future. Forecasts enable the companies to respond to the demands and challenges over the

future price control period, to innovate, provide a contemporary reflection of their customers' needs and wants and respond to the drivers and direction of the wider policy environment. So whilst historical performance is a useful indicator when assessing business plans, placing too much weight on it may not lead to conclusions that are in the long-term interests of existing and future customers.

- 8.2 We would suggest that Ofgem determining the revenues of an 'efficient' company is not a sound approach if used in the way suggested i.e. as a target for business plans. It is difficult to see how this type of approach could properly take into account future business plan approaches and associated costs, it risks stifling innovation or for plans to be a true reflection of customers' needs and wants. The approach of Ofgem to effectively substitute its view for that of the market is risky and could result in inefficiency and over reward. However, we would expect Ofgem to utilise 'reference values' in its assessment of business plans.
- 8.3 **Length of Price Control:** Our members' individual responses to the Open Letter contain a range of views on the question of what a longer price control period has allowed companies to accomplish or plan for that would not have occurred under a shorter price control period.
- 8.4 **Efficiency Incentive:** We believe that the IQI and efficiency incentive has generally worked well in revealing efficient cost through the business plan process and encouraging efficiency and savings through innovation. For the IQI and efficiency incentive to have maximum impact there needs to be timely publication of related instructions and guidance.
- 8.5 **Innovation:** The RIIO innovation stimulus has had significant success in encouraging network companies to bring forward innovative projects and embed a culture of innovation within their organisations. This has led to significant advances in the application of new technologies and techniques and the development of skills and capability within the organisations involved, to the benefit of current and future consumers. Indeed a key feature of the RIIO-1 innovation mechanisms has been the collaboration and sharing of best practice delivering both short term benefits shared with the customers of the innovating network and subsequent longer term customer benefits across all networks.
- 8.6 However, companies need to continue to be encouraged to increase their levels of innovation in order to most effectively and efficiently meet the challenges of a speedy and full transition to 'smart flexible' and 'green gas', and potentially hydrogen, low carbon networks. The future potential for developing new industrial capability, for example new products and services and the creation of new global markets, should also not go unrecognised. It is therefore imperative that innovation in networks continues to be strongly incentivised under future prices controls. New approaches, including the development of whole systems incentives designed to drive innovation,

used in combination with current type innovation support measures may also provide an attractive option, helping to deliver the energy system we will need in the future.

- 8.7 **Competition:** Competition is already well established across gas and electricity networks and our members agree that competition should be used where it can drive value for consumers. Networks are facilitators of competition, for example, the transition to a smart electricity grid will enable new markets and opportunities for distributed energy technologies, battery storage, solar panels and services such as electric vehicle to grid demand response. It will also enable maximum use of DER assets, access to markets, new business models and maximise the benefits of competition and third-party involvement.
- 8.8 Competition can deliver benefits for consumers where applied appropriately, for example, third party providers of innovative network solutions. However, it may also risk creating greater complexity across the networks, delay generation projects and introduce new risks or asymmetrical allocation of risks between the incumbent companies, third party providers and consumers, with little or no net gain for consumers. Therefore how and where competition might be applied in the future needs careful consideration.

Simplifying the price controls by focusing on items of greatest value to consumers.

9. **Business Plans:** We believe there are a number of elements of the price control process and framework that can be simplified. Clear guidance on the requirements for submissions, particularly financial, and allowing more time for review of outputs produced by Ofgem as part of the process e.g. models, tables and benchmarking should help to provide greater consistency of information presented across the network companies. Greater consistency could also be brought to the structure, information requirements and presentation of business plans which should aid assessment and comparison. However, companies need to be left with sufficient flexibility so as to enable the diversity that exists across the companies to be adequately reflected in their business plans.
- 9.1 Our members are of the strong view that plans should not be revised annually. The plans are a baseline for the whole of the price control period and are reported against annually, including deviations, by the companies with annual performance reports also produced by Ofgem. Multiple versions of business plans will not lead to improved information for stakeholders or improved assessment of performance. It is therefore difficult to see the benefits of such an approach.
- 9.2 **Fast Tracking:** The majority of our members support the inclusion of a fast-track and the incentive it provides for companies to deliver high quality business plans.

Ofgem may wish to review the uplift to WACC and sharing factors applied to those companies that successfully achieve fast-track and those that do not. The retention of any uplift to fast-track companies should be subject to actual performance against their forecasts.

- 9.3 **Monitoring and Information:** The amount of information collected by Ofgem by way of reporting requirements placed on network companies has grown considerably over the years. We believe that Ofgem should undertake a review of reporting requirements in terms of what aspects of the network's business is being reported against and the level of detail required. Part of this assessment should be whether and how the reported information is being utilised and whether there is scope for rationalisation or re-prioritisation.
- 9.4 **Separate ESO Price Control:** Our members are supportive of a separate SO price control as it is an obvious and necessary step in conjunction with the separation measures being undertaken.
- 9.5 **Stakeholder Engagement:** As above we believe that RIIO1 has delivered strong stakeholder engagement performance and we agree with the broad stakeholder approach set out in the open letter. We would encourage Ofgem to consider how its activities might be best co-ordinated and how to leverage the networks own stakeholder engagement so as to minimise burden on all those involved. It may also wish to consider the scope of stakeholders and where there might be read across or lessons learnt from other industries that have undergone the same transformative changes that are underway in the energy sector.
- 9.6 Ofgem should ensure that clear remits and terms of reference are set for any future working groups and to ensure that they deliver the desired outcomes at the right level of detail.
- 9.7 ENA hopes that this response to the Open Letter provides useful and constructive feedback to the issues and questions outlined in the letter. We are happy to provide further information on any aspect of our response.

4 September 2017