

Response to RIIO-2 Framework Consultation

Basis of response

The Energy Capital Partnership is the body responsible to the West Midlands Combined Authority and Mayor of the West Midlands for delivery of the regional energy strategy. It brings together the energy interests of 18 local authorities (including 7 metropolitan authorities) and three local enterprise partnerships; more than four million people living in two million homes and the highest concentration of manufacturing industry of any UK region. Several parts of the region have significant issues with fuel poverty, including large areas of Birmingham and the Black Country, particularly in private rented housing.

Following through on the recommendations of the King Commission into Regional Energy Policy¹, the Mayor is seeking to work with government, industry and Ofgem to develop better models for optimising energy networks to support the citizens and economy of our region. In particular, we have an interest in ensuring:

- Lower energy costs for the manufacturing firms which are the cornerstone of our economy
- Minimising the number of households at risk of fuel poverty
- Optimising potential economic benefits for our region from the global transition to a more distributed, cleaner energy system

We see appropriately targeted, timely and cost-effective energy infrastructure investment, properly aligned to strategic investments in housing, transport and economic infrastructure, as increasingly important to delivering these goals.

The region is currently enjoying a boom in investment and development, particularly around new HS2 terminals in Birmingham and the NEC, and in Coventry, which has ambitious plans around electric and autonomous vehicles. At the same time, both Birmingham and Coventry have long-standing challenges with their electricity distribution networks: Birmingham has significant fault level constraints and Coventry is wired at 6.6kV rather than the more usual 11kV.

Our primary concerns are: firstly, that the 'business as usual' model of energy infrastructure investment will not deliver timely support to our industrial strategy and thus hold back the economic development of the region, penalising consumers in multiple ways; and secondly, that in a time of rapid technical change continuing to pass the sunk costs of stranded (and/or outdated) infrastructure assets on a uniform basis through to our industries and households undermines the competitiveness of our most innovative and high potential businesses and sends inaccurate market signals to consumers.

We believe that a more strategic and flexible approach to incentivising network investments and allocating costs would deliver better and more cost-effective outcomes for customers. We also think that the new devolved and regional authorities across the UK create a helpful context and appropriate platform to support this.

¹ <https://www.energycapital.org.uk/energyinnovationcommission/>

Key points in response to the consultation

We broadly welcome the direction of travel set out by Ofgem in this consultation but suggest that democratically-elected regional governments create a new and more efficient channel for delivering many of the objectives identified, working as part of a coherent national framework. Specifically:

- **Giving consumers a stronger voice**

This is a critical objective, but the proposed approach is far too weak and needs to be strengthened by establishing strong and well-informed, democratically-accountable regional institutions able to act as intelligent and challenging customers for gas and electricity network operators.

The information asymmetries and differences in perspectives, interests and market power between individual consumers (including businesses) and energy infrastructure providers and regulators are massive, so engagement alone does not generally support delivery of efficient market outcomes. Regional authorities have a vested interest in long-term strategic infrastructure optimisation (and consumer votes) and the best picture of local needs. They should be the primary mechanism for giving consumers a stronger voice.

- **Responding to changes in how networks are used**

Even within our region, the distributed energy infrastructure required (and economically-optimal) for the areas around Coventry and their industrial and social ambitions is radically different from the optimal infrastructure needed to support the housing and established manufacturing of the Black Country, or to support the new transport hub at UK Central in Solihull. Major technical and political judgements are being made and risks taken on investment in electric vehicle infrastructure, hydrogen, building standards and spatial plans. These are all vitally important to on-going economic success of economies based on manufacturing, construction and transport².

It is critical that flexible mechanisms are incorporated in the price control framework enabling local responsiveness and risk taking (and risk bearing) by local economies. In particular, energy infrastructure must be planned in conjunction with transport, housing and economic infrastructure in an integrated way. Regional institutions, developed in partnership with Ofgem and network operators, provide the most efficient mechanism for delivering this.

- **Simplifying the price controls**

We welcome simplification. In our view considerable complexity inevitably arises from a structure where the accuracy and fairness of outcomes depends on predicting complex variables up to eight years in the future and often second-guessing rapidly changing and diverse local plans using only a single national framework.

A more flexible approach, recognising the potential contribution to simplification created by intermediary publicly-controlled regional bodies would be better. This should be coupled with shorter regulated periods (improving the potential accuracy of forecasts). A mixed model in which a portion of investment is managed nationally over longer timeframes and a portion flexibly and locally over shorter timeframes may be a more robust, simpler and cost-effective approach.

² We accept that these arguments apply much less to local economies primarily based around services, for example.

- **Ensuring fair returns**

The key to ensuring fair returns is to create stronger, more demanding customers and ideally as much competition as possible in infrastructure investment locally. This is increasingly possible with growing technology and infrastructure choice and diversity possible at local and regional level (without adding risk to the national networks).

Regulation should make a clear distinction between legacy and national infrastructure costs and local and future infrastructure investment (specifically in energy distribution networks). The latter should be procured competitively regionally working within a national regulatory framework which allocates the risks and rewards of such investments to local consumers (who are also local voters) – i.e., these costs are shown separately on local energy bills and allocated by local politicians according to local industrial strategy priorities.

- **Driving innovation and efficiency to benefit consumers**

We agree with encouraging competition and have already set out ways regional procurement bodies could facilitate, simplify and strengthen this approach.

In the West Midlands, we have pioneered the concept of Energy Innovation Zones, which are a more open and competitive version of Ofgem's Sandboxes. Four large-scale pilots are being developed across the region. We believe appropriate governance is key to maximising the benefits to consumers of such zones, and would like to work with Ofgem and industrial partners to develop sensible models which work for everyone. EIZs provide a simple model for the kind of targeting and transparency proposed by Ofgem.

Answers to your specific questions below.

For clarifications or further information, please contact:

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Question	Response
1.	<p>For distribution , we think it's important to align customer engagement groups with existing strategic planning and political boundaries. This is important because</p> <ul style="list-style-type: none"> • Customers relate to infrastructure outcomes (i.e., places created by effective integration of energy, transport, spatial infrastructure) not to technical silos such as electricity or gas • Cost effective, competitive outcomes require potent and informed customer groups, which are most easily and efficiently created by using existing stakeholder groups (i.e., already in possession of strategic spatial and infrastructure plans) ideally with democratic mandates. <p>For these reasons we believe distribution network operators should be required to engaged with customers through devolved regional authorities (or where these don't exist, local authorities or LEPs).</p> <p>No views on transmission.</p> <p>If you get the above right, the challenge group will not be necessary and costs can be avoided.</p> <p>Open hearings are a sensible idea.</p>
2.	<p>We support a reduced period for planning but would prefer more flexibility within this to avoid the delays and costs that longer planning periods create in a rapidly changing technical environment where other economic and spatial needs may be changing unpredictably at a far faster rate than five and eight year periods support.</p> <p>We would like Ofgem to consider more flexible funding mechanisms to support timely network infrastructure investments that will be critical to our region. We accept that this may require underwriting by regional bodies and local partnerships, but these are fundamentally best placed to take such risks (as they have most control over the rate and nature of local economic development). Differentiating between planning periods (shorter and more flexible) and allowance periods (more flexible depending on type of investment, and often potentially longer) would be helpful.</p> <p>The essence here is encouraging long-term thinking by network companies by allowing strategic customers (Places) to have more say over investment plans, rather than relying solely on the length of the price control.</p>
3.	<p>Customers relate to whole systems, which for us as a region encompasses transport, water, IT, waste and spatial infrastructure as well as energy.</p> <p>Facilitation of whole system outcomes is much easier and cheaper at regional level, provided this is embedded in a well-designed national framework. We think it would be helpful and result in lower cost whole system outcomes if Ofgem structured their thinking in this way.</p> <p>You need to prioritise flexibility within the price control framework (including in allowances over time (see q9)) provided this is accompanied by local customer engagement and appropriately designed and demonstrated 'whole system' planning approaches at regional level.</p>
4.	<p>We agree with your views on the limited value of aligning transmission and distribution price controls at this stage; we think the more important alignment is with regional</p>

Question	Response
	infrastructure planning, which is currently very different from national price control frameworks.
5.	We have concerns that attempting to resolve and design whole systems approaches purely at national level is a largely futile, if not impossible, task, and urge you to adopt a sensible analytical framework before doing this (analogous to making a distinction between transmission and distribution in energy, but with the scope broadened to consider all infrastructure systems).
6.	No comment
7.	No comment
8.	No comment
9.	<p>There are also scenarios in which customers are prevented from accessing the cost benefits of new energy infrastructure technologies because these technologies are considered as additional costs on top of what is (in comparison to competitor economies) actually now a redundant system (i.e., we are constrained to work with dated infrastructure and its costs because it's there and depreciation allowances were agreed in a world where its rate of redundancy was underestimated). This handicaps economic growth and adds costs to customers in a whole system view.</p> <p>This is partly why a whole systems approach is needed, and why it impacts price controls (q3).</p> <p>In some way or other, there need to be mechanisms for taking the costs associated with both</p> <ol style="list-style-type: none"> 1. Aged infrastructure whose economic lifetime has suddenly reduced, and 2. New infrastructure which is not subsequently needed <p>out of customer energy bills, potentially to a national or regional energy transition fund (depending on where voters are more or less willing to take risks).</p>
10.	This activity needs to be driven as close to consumers and customers themselves as possible (the clue is in the 'end-use' bit of the heading). Other approaches are likely to be exceedingly inefficient and costly (based on international experience). Network companies should be encouraged and incentivised to support end-use energy efficiency, but the lead should be regional and local delivery bodies, so the role should be supportive not directive.
11.	Innovation funding is helpful and should be retained, although greater engagement with regional partners to ensure alignment with whole system outcomes should be encouraged.
12.	<p>We agree with your three broad areas of reform, but would qualify our support for your point (ii) by noting that UK public sector innovation funding mechanisms have a history of being over-academic and failing to translate R&D into practical commercial outcomes. There are opportunities to do new and better things by combining funding from RII0-2 with UKRI and InnovateUK monies, and a model which is distinctively market and customer-focused would be welcome.</p> <p>In the West Midlands we sponsored a Commission last year to develop the concept of Energy Innovation Zones (our definition is somewhat more ambitious and broader than the</p>

Question	Response
	similar concept now being taken forward through the ISCF) and we would like to propose this as a model Ofgem should consider for delivering the reforms suggested.
13.	See previous answer. Regions and EIZs provide a manageable and focused framework for third party engagement.
14.	<p>It would be good to move beyond grants to consider flexible allowances and charging mechanisms for innovation in regional contexts (e.g., flexible allowances which are shortened for unsuccessful innovations and lengthened for successful ones within an agreed limit)</p> <p>This approach could support an innovation funding mechanism which benefitted from and incentivised successful innovation as well as covering the costs of inevitable and necessary failures.</p>
15.	See previous answer.
16.	We support extension of competition and agree with the proposal in the Helm Review that regional procurement bodies (RSOs) could support this, particularly in the context of delivering whole system outcomes in the distribution networks.
17.	No comment
18.	No comment.
19.	No comment.
20.	See previous responses.
21.	No views.
22.	No views.
23.	No views.
24.	No views.
25.	No views.
26.	No views.
27.	No views.
28.	No views.
29.	No views.
30.	See previous comments about consumer engagement. This needs to go beyond either random collections of invited individuals and/or national consumer groups. Alignment with democratically-accountable local strategic infrastructure planning bodies (local and regional authorities) is fundamental.

Question	Response
31.	No views
32.	Aligning them with regional political and planning boundaries would be most helpful.
33.	No views.
34.	No views.
35.	No views.
36.	No views.
37.	No views.
38.	No views.
39.	No views.
40.	No views.
41.	No views.
42.	Economic asset lives are becoming increasingly dynamic and are a function of innovation and global competition in infrastructure systems. Fixing them at the point investments are made is likely increasingly to hinder the delivery of UK and regional industrial strategy.
43.	No views.
44.	No views.
45.	We think there is a greater role for competition in ensuring fair returns (at least for distribution networks) provided this is accompanied by strengthening of regional institutions to act as effective infrastructure customers.
46.	No views.
47.	Our view is that many of the interlinkages will be simpler and easier to manage within a framework which includes a role for regional public institutions acting as local whole system customers – particularly for infrastructure - on behalf of their citizens. We encourage Ofgem to adopt such a framework.
48.	No views beyond those already covered.
49.	No views beyond those already covered (see q47 especially).
50.	No views beyond those already covered.