

## **RIIO 2 Consultation BEAMA Networks Response**

BEAMA is the trade association for the UK electrotechnical and allied industries, representing over 200 manufacturers in sectors including networks, smart energy, electrical infrastructure and heating, ventilation and plumbing. This consultation response is an organisational response based on input from our staff and membership.

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### **Giving consumers a stronger voice**

Q1. How can we enhance these models and strengthen the role of stakeholders in providing input and challenge to company plans?

- What are your views on the proposal to have Open Hearings on areas of contention that have been identified by the Groups?

BEAMA strongly contends that the supply chain for T&D products and services should be included amongst the stakeholder groups. Delivery of the RIIO 2 outputs will depend on the capability of the supply chain and their views must be considered. Network companies should be expected to set out their supply chain strategy as part of their business plans. It follows that, to complete this section, they would need to include the supply chain in their stakeholder groups.

Whilst it is highly desirable to take account of consumer views in developing the business plans, it is unlikely that many consumers will be equipped or willing to understand the more technical aspects of the network plans. It would of great value if the network companies were able to explain these aspects to a broader public audience and should be judged on their success in this. This may force them to identify the essence of their proposals and inhibit the tendency to hide important issues within extensive detail. Alongside this exercise, Ofgem should also look to other stakeholder groups for feedback on the effectiveness of the network business plans, primarily those group that are undertaking detailed review of these aspects of the plans. This is reflected in the Ofgem proposals for transmission but should be extended to distribution.

### **Length of price control -**

Q2. Do you agree with our preferred position to set the price control for a five year period, but with the flexibility to set some allowances over a longer period, if companies can present a compelling justification, such as on innovation or efficiency grounds?

The difficulty of predicting allowances is recognised by BEAMA and was indeed a major conclusion of the Cost of Energy report. This will become more of an issue as the rate of innovation and change increases. As such, moving back to a 5 year period would seem sensible. However, in RIIO 1, it was the early years that were at most variance with the agreed allowances, which years would have been expected to be the most accurate as there was less time between the development of the plans and their implementation. This suggests that it was not simply uncertainty that caused the divergence from plans. The CEPA reports can be interpreted as supporting the view that some of the network

companies were gaming RII 1 to maximise their returns. This will not be resolved by shortening the period but by revision to the outputs so that they provide more immediate response to investment decisions. This issue is discussed later under Question 20 .

- What type of cost categories should be set over a longer period?

Whilst load related investment can be subject to uncertainty, network maintenance should be more predictable, and it should be subject to longer term planning. It would assist the supply chain if these plans were set out over a longer term. It would also assist innovation if maintenance needs were planned over a longer term so that new approaches had longer investment periods to compete for.

- How could we mitigate the potential disruption this might cause to the rest of the framework?

No good reason can be seen why it should not be possible for the business plans to have indicative longer term programmes set out in them which are approved alongside shorter-term spending plans and included, still included in the periodic reviews but with an expectation that they will be rolled over unless there is compelling evidence for changing them.

- What additional measures might be required to support longer-term thinking among network companies?

The network companies should be required to set out their plans within the framework of the government's carbon reduction policy.

- Do you instead support the option of retaining eight-year price controls with a more extensive Mid-Period Review (MPR)?

BEAMA does not support retention of the 8 year period.

- What impact might the alternative option of an eight-year price control with a more extensive MPR have on how network companies plan and operate their businesses?

Much depends on the nature of the reviews. If these are fundamental and need major revisions to business plans, then this will lead to short term behaviours. Alternatively, if the reviews are designed to refine business plans in the light of innovation and improved knowledge, network companies should be able to commit to long term plans. However, this was the principle behind the current 8 year period so much depends on the correct design of the outputs.

### **Whole system outcomes –**

Q3. In what ways can the price control framework be an effective enabler or barrier to the delivery of whole system outcomes?

- If there are barriers, how do you think these can be removed?

Barriers arise from companies having an interest or need to affect areas outside of their direct responsibility or control. For instance, there is a clear possibility that there can be conflicts between the needs of transmission and distribution.

Ofgem should develop the TSO and, more urgently, DSO roles to take responsibility for ensuring all technical options for network development are considered. The TSO could have an overall roll to ensure compatibility between the Transmission and Distribution elements.

Whole systems outcomes also imply the use of parallel energy vectors in finding an overall optimised solution. This would imply, for instance shifting investment from the electricity to gas network (or vice versa) if this gave the lowest cost solution. Some companies have both gas and electricity network assets and so might directly benefit from such a switch in investment. However, many companies would not be rewarded under existing regulation for another energy vector and so would have no incentive to develop this. This will, however, look similar to an investment in DSR, for instance, where this is undertaken in place of network reinforcement. So long as the network company can be rewarded for avoided investment then there should be an incentive to look for whole system solutions.

- What elements of the price control should we prioritise to enable whole system outcomes?

Establishing the TSO and DSO roles in order to provide neutral bodies able to identify whole system options is a top priority.

Q4. Do you agree with our minded-to decision to retain the current start dates for the electricity transmission and electricity distribution price controls, and not align them?

BEAMA has no views on this

Q5. In defining the term 'whole system', what should we focus on for the RIIO-2 period, and what other areas should we consider in the longer-term?

Development of the TSO and DSO role to provide a neutral view of options for network development and interaction between different energy vectors.

Recent proposals by the Energy Systems Catapult for regional Energy Innovation Zones would provide bodies that the DNOs/DSOs could interact with to inform their contribution to the broader overall local energy system. This would naturally fit into the responsibility of the DNOs to engage with their stakeholders and would also allow them to fit into a wider system view.

In addition, whilst there is currently a lot of discussion around potential benefits to TSO-DSO collaboration between networks there is little discussion around the DSO-DSO boundaries where there may also be potential to couple neighboring network areas operating under different licenses. BEAMA considers that this area should be given some focus.

- Are there any implementation limits to this definition?

Rewarding network companies for avoiding reinforcement investment runs the same risks as are currently being dealt with; specifically, the alternative is much cheaper or the allowance too generous so that rewards become excessive. This should be captured by Ofgem proposals for limiting network returns.

### **System Operator price control**

Q6. Do you agree with our view that National Grid's electricity SO price control should be separated from its TO price control?

Yes, BEAMA considers that it is vital that the system operator role is established so that network planning can be separated from network ownership. By definition, the price control for the TSO must be separate and different from the TNO's.

Q7. Do you agree that we should be considering alternative remuneration models for the electricity SO?

- If so, do you have any proposals for the types of models we should be considering?

Yes, BEAMA considers that the key is in ensuring that planning decisions are neutral between the different technical options and making sure that they are considered alongside each other. The TSO should have no interest in the financial outcomes for the TNO. The TSO should have clear outputs, primarily related to putting in place neutral markets for network development and should be rewarded for their success or otherwise in doing this.

### **System Operator price control**

Q8. Should we consider alternative remuneration models for the gas SO?

- If so, why and what models?

BEAMA has no comment.

### **Network utilisation, stranding and investment risk**

Q9. What options, within the price control, should be considered further to help protect consumers against having to pay for costly assets that may not be needed in the future due to changing demand or technology, while ensuring companies meet the reasonable demands for network capacity in a changing energy system?

It must be recognised that, in a time of rapid change, especially in demand for connections and power, that there is a real danger that demand for electricity arising from EVs can increase faster than network companies (and their supply chains) can satisfy. It follows that there is risk both in unnecessary investment and delayed investment. Simply waiting for the need for network investment to reveal itself and then to respond can be very negative for consumers. Network companies should be expected to state in their business plans how they are dealing with the balance between these risks

This is essentially a question of who to trust; which parties can be relied on to make neutral and, as accurate as possible, judgements on the future needs of the networks and consumers. It may be necessary to agree future demand scenarios and allow the networks to invest in meeting these demands with limited penalties for stranded investments. It will be important to establish the roles of TSO and DSO to ensure a neutral view on what future demand will be and whether there is a credible plan to meet it.

There are various options for meeting increased demand for power (for instance flexibility and reinforcement) and there is a need to decide early what approaches will be viable and their expected outputs so that network planning can be based on best understanding of available technologies. Based on this approach the networks should be expected to provide strategic plans on how they will meet future demands. The supply chain should also be consulted on what innovation will offer in terms of avoiding simple reinforcement.

### **End-use energy efficiency**

Q10. In light of future challenges such as the decarbonisation of heat, what should be the role of network companies, including SOs, in encouraging a reduction in energy use by consumers in order to reduce future investment in energy networks?

- What could the potential scale of this impact be?

There is a real risk that giving DNOs a responsibility for energy efficiency will create overlap with ECO and cause confusion amongst consumers. There is a logic that ECO should be given the scope of reducing volume (kWh) which is the energy Suppliers' main concern and network companies should have a scope of reducing capacity demand (kW), which is their main driver. This would then create an overall and complementary capability for supporting customers through the energy transition.

### **Innovation**

Q11. Do you agree with our proposal to retain dedicated innovation funding, limited to innovation projects which might not otherwise be delivered under the core RIIO-2 framework?

Yes, BEAMA considers that network companies should be taking responsibility for their own R&D activities so customer funded R&D should go towards areas that do not fall under the direct responsibility of the network company and would otherwise not be carried out. Network companies should be expected to set out their plans for their own internal R&D in their business plans and this should be tracked and included in their outputs. Where they have funded R&D with their own investment, network companies should not be expected to share the outputs.

Q12. Do you agree with our three broad areas of reform: i) increased alignment of funds to support critical issues associated with the energy transition challenges ii) greater coordination with wider public sector innovation funding and support and iii) increased third party engagement and (including potentially exploring direct access to RIIO innovation funding)?

Yes.

### **Innovation**

Q13. What are the key issues we will need to consider in exploring these options for reform at the sector-specific methodology stage, including:

(i) What the critical issues may be in each sector and how we can mitigate the bias towards certain types of innovation through focusing on these issues?

This requires a neutral body to identify the issues and ensuring that these are described in a technology neutral form. An example of how this might be done is shown below:

Issue: Lack of network inertia

Description: Rate of change of voltage beyond specified limits

Mitigations: Any and all measures that address that parameter

(ii) How we can better coordinate any dedicated RIIO innovation funding with wider public sector funding and support (including Ofgem initiatives such as the Innovation Link and the Regulatory Sandbox)?

A neutral body should have the role of delivering this. The proposed Energy Innovation Zones could play an important role in this.

(iii) How we can enable increased third-party engagement and what could be the potential additional benefits and challenges of providing direct access to third parties in light of the future sources of transformative and disruptive innovation?

For highest priority issues there should be an open call for solutions awarded by the neutral body. Network companies should be incentivised to compete to host the winning bids.

Q14. What form could the innovation funding take.

- What would be the advantages and disadvantages of various approaches?

Q15. How can we further encourage the transition of innovation to BAU in the RIIO-2 period? How can we develop our approach to the monitoring and reporting of benefits arising from innovation?

BEAMA proposes that, for technologies that have been developed and demonstrated overseas there should be no need to repeat trials that have already been undertaken elsewhere. The insistence on putting well-developed equipment through a trial stage is acting as a real barrier to the introduction of innovation into the UK. The TSO / DSO should have a role in looking at all options and introducing innovation where this is most cost effective.

A better mechanism is required from DNOs to provide visibility of innovation trials that have been complete and will actually move to BAU. Ofgem must avoid this innovation funding creating monopolies within the industry.

RIIO Innovation funding serves an important purpose in attracting new players and smaller SMEs into the Industry to help move the industry forward. However, DNOs must also engage more proactively with the larger technology companies whose primary motivations are not to be awarded innovation funding. These companies are more than willing to innovate and develop using their own R&D funding if the right level of engagement and detailed problem sharing is provided by network companies. This would represent better value for money for consumers.

BEAMA also considers that the use of tendering for network services (see Q16) will open the market to innovation as the use of innovative technology would most likely result in a lower bid.

## **Competition**

Q16. Do you agree with our proposal to extend the role of competition across the sectors (electricity and gas, transmission and distribution)?

Yes. In general, risk should be carried by those bodies most able to manage it and this can often be the provider of the service or asset. Care should be taken, though, that the network companies do not seek to offload risks that they cannot control to other companies that are no better equipped to manage them. The views of companies that might tender should be sought to ensure that there is a reasonable balance between commercial risk and reward and that there is fair competition with the local DNO. There is always an inherent advantage to network companies in bidding for much of this work as they can access lower cost funding and this advantage should be neutralised.

- What are the trade-offs that will need to be considered in designing the most efficient competitions?

Q17. Do you consider there are any reasons why our new, separable and high value criteria might not be applicable across all four sectors?

- If so, what alternative criteria might be suitable?

Q18. What could the potential models be for early stage competitions (for design or technical solutions)?

- What are the key challenges in the implementation of such models, and how might we overcome them?

Efforts should be taken to make sure that tenders do not assume specific solutions and exclude other innovative solutions. Tenders should be specified by the DSO/TSO in a technology neutral format so that all options can bid into them on an equal footing.

### **Our approach to setting outputs**

Q19. What views do you have on our proposed approach to specifying outputs and setting incentives?

- When might relative or absolute targets for output delivery incentives be appropriate?

BEAMA has no comment

- What impact would automatically resetting targets for output delivery incentives during a price control have? Which outputs might best suit this approach?

BEAMA has no comment

### **Our approach to setting cost allowances**

Q20. What views do you have on our general approach to setting cost allowances?

There is a danger that Ofgem will become increasingly involved in management decisions made by the DNOs. The basic principles of RIIO are sound and the TNOs and DNOs should have freedom to find the most efficient means of delivering their outputs. What is needed are output measures that are sensitive to the behaviours of the network companies within the period of the regulatory review. For instance, RIIO 1 set network reliability outputs that the DNOs were already largely exceeding. The solution to this is not to move away from RIIO principles but to improve its implementation.

Q21. What views do you have on our intention to index RPEs?

BEAMA has no comment

Q22. What impact would resetting cost allowances based on actual cost performance (eg benchmarked to the average, upper quartile or best performer) during a price control have? Which cost categories might best suit this approach?

BEAMA has no comment

### **Information-revealing devices**

Q23. Do you agree with our assessment of IQI?

Q24. Do you agree with our assessment of fast-tracking?

BEAMA has no comment

### **Information-revealing devices**

Q25. What are your views on the options we have described?

BEAMA has no comment

- How might these apply in the different sectors?
- Should we retain the IQI, amend it or replace it entirely?

Q26. What factors should we take into account when assessing plans for example, under fast-tracking (option 2) or a single business plan incentive (option 3)?

Q27. Do you have any views on the factors we should take into account when deciding how to differentiate efficiency incentives for companies if we do not use the IQI?

Q28. Is an explicit upfront financial reward required to incentivise companies to submit high quality business plans, in addition to differential incentive rates or sharing factors?

Q29. Do you have any views on our proposal to remove fast-tracking for transmission?

Q30. Do you have any views on how we propose to incentivise better business plans from transmission companies, including removing the prospect of an upfront financial or procedural reward and placing greater reliance on user and consumer engagement and scrutiny?

### **Annual reports/reporting**

Q31. How can we best improve the suite of annual reporting requirements to be as efficient and useful as possible?

Q32. How can we make the annual reports easier for stakeholders to understand and more meaningful to use?

At a very basic level, Ofgem should keep the annual reports consistent. Within RIIO 1 there have been fundamental changes to the report format after just a few years which make it impossible or very difficult to track delivery across years.

Where network companies are claiming that they have outperformed their allowance, they should be expected to provide public evidence for how they have achieved this to substantiate their claims.

### **Cost of debt**

Q33. What are your views on the policy objectives that we have defined with respect to the cost of debt?

Q34. Which option might help to ensure that the approach to updating the cost of debt methodology delivers best value to consumers and why?

BEAMA has no comment

### **Cost of equity**

Q35. Do you agree with our proposed methodology to estimate the cost of equity?

Q36. Do you agree it would be desirable to index the cost of equity?

- Do you have views on our proposal for indexation?

BEAMA has no comment

### **Financeability**



Q37. Do you consider there is merit in removing the indexation of the RAV and adopting a nominal return model in RIIO-2?

- What would be the benefits and drawbacks?

Q38. Should the onus for ensuring financeability lie with the network operating companies in whole, or in part?

Q39. Do you consider the introduction of a revenue floor, to protect the ability of companies to service debt, to have merit?

BEAMA has no comment

### **Corporation tax**

Q40. Do you agree that Ofgem should review the causes of any variances between tax allowances and taxes actually paid to HMRC (including the treatment of group tax relief)?

- Which of the options described in this consultation may be worth investigating further to address any material variances?

BEAMA has no comment

### **Other finance issues**

Q41. Do you agree that we should move away from RPI for RIIO-2 (including for the indexation of the RAV if retained as a feature)?

- If yes, which of the two potential indices – CPI or CPIH – might be most suitable?
- Is a phased transition between RPI and the chosen successor index necessary or desirable?

Q42. In the light of our proposal not to amend, at a price control framework level, our policies for depreciation and asset lives set in RIIO-1 do you have any views or suggestions that you wish to put forward?

Q43. We propose to review the fast/slow money split at the business plan submission stage, do you have views that you wish to put forward at this stage?

Q44. Do you think existing mechanisms for providing allowed revenue to compensate for the raising of notional equity are appropriate in principle and in practice?

BEAMA has no comment

### **Ensuring fair returns**

Q45. What are your views on each of the options to ensure fair returns we have described?

Q46. Is RoRE a suitable metric to base return adjustments on?

- Are there other metrics that we should consider, and if so why?

BEAMA has no comment

### **Next steps**

Q47. Do you have any views on the interlinkages and interactions outlined in this consultation and those that we will need to consider as we develop our sector specific proposals?

BEAMA has no comment

### **Next Steps**

Q48. Do you have any views on the issues highlighted that we will consider as we develop our sector-specific proposals?

BEAMA has no comment

Q49. Are there any sector-specific issues or policy areas that we should ensure we review and consider as we develop our sector-specific proposals?

BEAMA has no comment

### **Question**

Q50. Do you have any views on our high-level proposals for timing of RIIO-2 implementation, and on our proposals for engagement going forward?

BEAMA has no comment