

Utilitywise Response to The Office of Gas and Electricity Markets (Ofgem) consultation on the RIIO-2 framework

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About Utilitywise:

Established in 2006, with parts of our business trading since the 1970s, Utilitywise is one of the UK's leading business energy and water consultancies. Utilitywise specialises in gas, electricity, and most recently water procurement, and in energy management and compliance services for businesses of all shapes and sizes, helping them buy better and use less.

We're constantly growing our team and expertise, having made key acquisitions since our AIM listing in 2012. In April 2016 we announced our partnership with Dell to bring Internet of Things (IoT) Building Automation solutions to our clients, to help them better control their energy use.

The Group's comprehensive offering services to c.40,000 clients from SMEs to multinationals across the UK and is expanding its services into Europe. Working on behalf of some of the UK's largest energy users, the Utilitywise Corporate Division offers an all-encompassing range of services to over 800 clients, spread across a variety of sectors.

This response argues that:

- Customer engagement should be enhanced, as suggested by Ofgem, with the inclusion of TPIs in the discussion;
- The reversion back to a five-year review period would be welcomed;
- RIIO-2 should be used to encourage the transition of the energy market towards the 'smart grid' as part of the considering whole system outcomes;
- Energy efficiency should be encouraged across power, gas, heat and transport sectors

Proposals - Giving consumers a stronger voice

With the energy industry undergoing a period of rapid transformation, consumer engagement is becoming increasingly important. We hope the change in the way networks' business plans are assessed will allow the consumer - from domestic to large end-user - to voice their concerns on how network revenues are decided. This will ensure network businesses commence engagement activities much earlier than ever before and would also increase transparency and openness within the Business Plan development process.

Utilitywise believes that consumer representative groups such as Third Party Intermediaries (TPI) would be able to actively participate in the new engagement process as they could provide the appropriate level of scrutiny and industry insight to contribute. As a TPI, we believe we could provide a valuable input in the long-term interest of consumers and also help network companies to develop understanding of the key concerns faced by small and large businesses during a network price control determination.

As proposed in the RIIO-2 Framework consultation, the Customer Engagement Group in distribution and the User Group in transmission are not expected to discuss or review network companies cost of capital or financeability, but rather consider output performance targets and incentives, as well as more strategic issues associated with energy system transition. These are areas which we believe we could contribute to and therefore support the Authority proposals which will see the use of consumer groups to assess network companies' business plan before releasing them to the regulator.

Proposals - Length of the price control

We believe a price control regime would still be an appropriate tool to regulate the future energy system. We are pleased to see the Authority is considering introducing a shorter, 5-year price control period – a proposal which we supported in our response to the Department for Business, Energy and Industrial Strategy (BEIS) Cost of energy review consultation. Given the fast-paced evolution of the energy network, an 8-year duration for the price control period is impractical. However, if the longer timescales are retained, we would want to see the next price control putting more pressure on network companies to limit their costs and reduce charges paid by consumers. In addition, the mid-period review (MPR) process would need to be supported by an independent auditor to improve forecasting accuracy or exposed to more stringent, industry-wide review to maximise consumer benefit. Currently the MPR is not designed to introduce significant changes to price controls and the process would need to be revised to ensure network companies keep pace with the energy transition.

Utilitywise believes shorter timescales would allow for less uncertainty in the price control frameworks. The proposed 5-year duration is more appropriate and will allow for greater cost certainty for consumers, with changes to network charges less frequent. Utilitywise also believes that the shorter timeframe will mitigate the risk of consumers paying for costly infrastructure which might become redundant due to advances in smart and more flexible technologies take-up, such as smart meters, Internet of Things (IoT) and connected devices. Today, there are around 20bn connected devices, and by 2020 that figure is expected to increase to 200bn. The proportion of companies using IoT has more than doubled since 2013. In Europe, the adoption of IoT has increased from 11% in 2013 to 26% in 2017. The wider adoption on IoT in the energy industry will open new opportunities for the improved management and maintenance of building systems. IoT allows for devices to connect and exchange data helping consumers to better control, monitor and meter their energy usage.

Utilitywise are aware of current work under Ofgem's Significant Code Review into charging as well as the future of supply market arrangements and wants to see more clarity on what the changes will mean for businesses. One of the options considered for residual charge recovery will impact all businesses with onsite generation. Affected businesses will be forced to pay network charges even when using electricity generated from their own facility. Such a move could significantly damage the growth of the demand-side response (DSR) market. Utilitywise believes that appropriate charging signals need to incentivise the take-up of flexibility – battery storage, DSR and electric vehicles.

Whole system outcomes

In our view, the networks price control incentive structure should encourage best-practice network planning that will deliver value to consumer via lower electricity and gas prices. The growth of IoT technologies, smart appliances and local energy system management would drive the need to better coordinate resources across the whole energy system.

In electricity, the transition from distribution network companies (DNOs) to distribution system operators (DSOs) is already taking place. RIIO-2 is the right place to make changes to support the transition. These reforms need to enable smart grid efficiencies to flow into the system with the growing role of renewable generation, energy storage technologies and DSR. Therefore, Utilitywise would want to see an incentive for network companies to delivering local markets for flexibility in the next price control. Currently, the Environmental Discretionary Reward in electricity transmission provides an incentive for companies to build a smarter network, integrating DSR and energy storage along with other low carbon objectives. However, there is no similar equivalent in electricity distribution. The only requirement is for companies to produce an Environmental report, with no reward/penalty mechanism attached or specific energy efficiency reporting requirement. RIIO-2 needs to strengthen this incentive. As the energy transition increases in its pace, the provision of real-time information on distribution connected renewable generation and energy storage technologies would become increasingly important.

Another key consideration for the next price control is an improvement in data sharing. With improvements in data collection and analysis, the system would be better equipped to manage the growing percentage of distribution linked renewable generation and also identify electric vehicle clustering areas in the future. This insight would be incredibly valuable in the future. Utilitywise wants to see the price control incentivising companies to improve their data sharing practices which would benefit the wider energy system planning and development. The information exchange needs to encourage the open sharing of data to all industry parties, including TPIs. The Competition and Markets Authority mandated that TPIs have access to electricity and gas data provided by Electricity Central Online Enquiry Service (ECOES) and Data Enquiry Service (DES), which was a welcome move, but only limited to domestic consumer data. We want to see the Government continue to remove barriers and promote open access for TPIs, which will increase consumer benefit and support the energy transition. Utilitywise believes that open and equal access regime to sharing of data between transmission and distribution companies would promote competition and encourage investment in the right places. Increased data sharing would support new emerging business models in the future, however it will require updating security and privacy arrangements.

Utilitywise welcomes Ofgem's proposal to incentivise whole system outcomes which need to promote the growing market for demand reduction and flexibility as well as data sharing. There is more imminent need to improve visibility of distributed energy sources and EVs on the network. Making it possible for the price of electricity to be seen in real time would improve the cost transparency of different power sources, and encourage immediate DSR which could even be delivered by EVs in the future. When thinking about whole system outcomes both gas and electricity networks need to be required to carry out impact

assessment analysis prior to making an investment decision which will need to consider whether a transmission constraint could be addressed similarly from the distribution side by providing an appropriate DSR response. In the long term, it is likely that consumer interaction with the electricity industry will change with the need to consider the benefits multiple trading relationships could provide. In our view, it would be easier and more consistent if both transmission and distribution price controls have the same start date. However, this might distort the focus away from making the next price control more adaptable to system uncertainty. Thus we believe aligning the networks' start dates would be more appropriate to be considered for RIIO-3.

Proposals - End-use energy efficiency

Utilitywise is supportive of the proposals which could present the opportunity for new energy efficiency schemes available for businesses. However, the incentive put on networks does not need to be limited to the heat sector only. As the next set of price controls would be designed with a whole system thinking, it is logical to encourage energy efficiency across power, gas, heat and transport sectors. We have seen the benefits energy sensors and smart control systems could provide for the whole system with IoT solutions able to deliver 20% savings on businesses operating costs. Utilitywise believes the next price control is the right place to incentivise network companies to remove inefficient barriers to new technology adoption.

The rise in smart devices would also need to encourage the adoption of service-based and cost reflective pricing. Distribution companies are already able to encourage more energy efficient consumer behaviour. Only recently, a distribution change proposal (DCP161) came into force which introduced tougher penalties when consumers breach their capacity use thus encouraging more energy efficient end-user practices. Time of Use pricing would encourage energy efficiency across sectors and smart controls adoption would optimise end-consumer demand. Unless parties see the real distribution and transmission costs of their decisions, they are unlikely to adopt the most appropriate technologies.

There is scope for significant energy cost reduction as result of smart technologies take-up and development of IoT within the energy sector. We believe that IoT solutions could deliver 20% savings on businesses operating costs. However, currently there is little policy support for releasing cost efficiencies from equipping buildings with energy efficient smart technologies. Access to real-time insights and data would improve consumer engagement in the market changing the current energy system model. Big data captured by smart buildings through IoT technologies can enable owners to deliver energy savings, which will provide tenants with commercially valuable insights. Utilitywise view is that current energy efficiency policy needs to evolve in order to support the smart energy transition, IoT technologies and greater access to data. While large enterprises are more familiar with IoT and the benefits it affords, Utilitywise believes there is still a lack of awareness among SMEs. Utilitywise believe raising awareness among SMEs which will contribute to the next wave of adoption.

There are policies such as Energy Saving Opportunity Scheme (ESOS) which give large business a framework and menu for what technologies are suitable, their associated cost and payback. However, the Government channels its money into big projects at a far higher cost,

which benefit foreign investors rather than support medium to large businesses both from a technology deployment and a reducing energy costs point of view.

Proposals - Encouraging competition and fair returns

The energy industry has already seen the benefits of competition within the electricity onshore and offshore transmission. Utilitywise supports extending market-based approaches to electricity distribution and hopes that this could lead to greater efficiencies and lower charges to the consumer. This includes meeting future requests for network connection, accommodating new market entrants and trading platforms as well as data management and privacy. Opening DSO-led flexibility markets to competition would also provide benefits across the whole system including transmission, transport and heat and encourage better coordination of resources.

It might be a good option to consider testing the competition model on new connections only in order to make sure it is good value for money. Utilitywise believes there would be significant benefit from expending competition to electric vehicle charging point infrastructure across network companies and other agents (e.g. fuel retailers). This could lead to lower deployment costs of EV charging. However, we need more clarity if this would be subsequently passed on to consumers.

Utilitywise supports the introduction of a failsafe option into the next price control and hopes that the chosen approach would provide faster response to changing consumer demands or technology adoption than the current MPR process. In combination with proposed lower rate of return and shorter period, the failsafe mechanism should incentivise companies to streamline their operations and benefit consumers through lower future network charges.

For further information please contact:

Paul Anderson
paul.anderson@utilitywise.com