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RIIO-2 framework consultation

EDF Energy is one of the UK's largest energy companies with activities throughout the energy chain. Our interests include nuclear, coal and gas-fired electricity generation, renewables, storage, and energy supply to end users. We have over five million electricity and gas customer accounts in the UK, including residential and business users.

Summary

We welcome the opportunity to engage in the proposals for the RIIO2 framework. The network businesses play a critical role in the energy system and it is essential that they are regulated in a way that delivers necessary infrastructure investment and reliable operation at reasonable cost.

Energy prices are a very real concern for households and businesses and network costs comprise a considerable part of consumers' bills (c26% for domestic dual fuel). Through RIIO2 Ofgem must ensure that consumers pay a fair price for the operation and financing of these businesses; high rewards should only be justified by high performance. In doing so Ofgem must ensure that the current level of network resilience and reliability that consumers enjoy is not put at risk along with the delivery of new infrastructure to support sources of low carbon generation.

A key part of RIIO2 will be delivery of 'load related' expenditure. There are likely to be some material changes on the demand side over the coming period with increasing electrification of transport and heat, and on the supply side with growth in both decentralised generation and large-scale, low carbon generation. RIIO2 will be key to support timely delivery of the network infrastructure needed to support Government policy. For instance there may be scope to improve the interactions between Ofgem's strategic wider works process, including network competition, and Government mechanisms to support deployment of large scale low carbon generation.

We support the proposal for a shorter 5 year price control period. This will allow earlier review of controls to ensure that they are still appropriate and the network companies are on track and to mitigate, to some extent, risks of windfall gains. With the separation of the TO and SO, we consider it is appropriate that they have separate price controls so that the SO is fully decoupled under regulatory framework. We do not see a need to align the

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start dates for the transmission and distribution price controls – this would create significant administrative burdens and risks delays to the delivery of potentially important consumer reforms. If, through the whole systems work, it is identified that reforms are needed to the electricity distribution controls to fully deliver benefits then we believe a form of workaround could be found if needed for the two year period in question.

For the ESO we believe that this interim 3 year period in the run up to 2021 will give useful insights to confirm whether the current approach to ESO regulation, with challenge panel, forward work plan and broader incentives, is effective. In principle this approach appears to be a pragmatic way to balance incentives to mitigate short term costs while also encouraging broader forward thinking, and investment, to deliver medium term benefits for consumers.

We support Ofgem's focus on 'whole system' costs as part of the regulatory framework. It is important that the network companies make effective trade-offs between distribution and transmission investments to meet needs as well as market based solutions and encouraging flexibility from users. We recognise the potential for flexibility to deliver real benefits in deferring or substituting costly asset-based solutions but, in the near term, these are likely to be localised and limited in potential. A key part of this review will also be to ensure that significant improvements in data and information sharing occurs between the network companies to recognise the significant growth in decentralised energy sources. It is particularly important for DNOs to share information with the ESO to allow them to develop the right tools to best balance and operate the system as a whole at least cost.

Consumers and businesses also benefit from predictability of charges. This is important within price control periods to minimise pricing risk being factored into retail pricing. It is even more important at the end and beginning of price controls as there is 'cliff edge' risk if there is structural change with the potential for significant impact. We would therefore seek assurances that mitigation, such as a 'glide path', is put in place if there is a significant material impact to enable businesses to plan ahead and adjust their business models. A way to achieve this would be to set the allowed revenues for the start of the new price control in a timely manner with reconciliation to the final allowed revenues after the go-live date. This would allow suppliers enough time to factor the step changes into contracts with their customers. As an example, in the last distribution price control, the revenues for the first year were set on initial proposals which were reconciled with the final proposals in the following year.

Finally in terms of process, we agree and support transparency and stakeholder engagement to provide input and challenge to the network companies' business plans. We are concerned that despite effort there is a risk of fragmentation in this process - for instance for electricity transmission alone EDF Energy might be expected to engage separately with the ESO, National Grid TO, SHET and Scottish Power TO. This is a significant commitment and we would not wish to see other routes for engagement closed off outside of these groups.

We look forward to continued engagement in the RIIO2 consultation process.

Our detailed responses, where we have a view, are set out in the attachment to this letter. Should you wish to discuss any of the issues raised in our response or have any queries, please contact Mark Cox on 01452 658415 or myself.

I confirm that this letter may be published on Ofgem's website.

Yours sincerely,

Angela Hepworth
Corporate Policy & Regulation Director

Attachment

RIIO-2 framework consultation

EDF Energy's response to your questions

Chapter 3 - 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?**

We consider stakeholder engagement to be important to provide input and challenge, both when price controls are set and to monitor performance. This though needs to be targeted to maximise stakeholder engagement and mitigate resource implications otherwise this could limit effectiveness.

We are also concerned that despite effort there is a risk of fragmentation in this process - for instance for electricity transmission alone EDF Energy might be expected to engage separately with the ESO, National Grid TO, SHET and Scottish Power TO. This is a significant commitment and we would not wish to see other routes for engagement closed off outside of these groups.

Chapter 4 - Responding to how networks are used

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?

- **What type of cost categories should be set over a longer period? How could we mitigate the potential disruption this might cause to the rest of the framework?**
- **What additional measures might be required to support longer-term thinking among network companies?**
- **Do you instead support the option of retaining eight-year price controls with a more extensive Mid-Period Review (MPR)?**
- **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?**

We support the proposal for a shorter 5 year price control period. This will allow earlier review of controls to ensure that they are still appropriate and the network companies are on track and to mitigate, to some extent, risks of windfall gains. With the separation of the TO and SO, we consider it is appropriate that they have separate price controls so that the SO is fully decoupled under regulatory framework.

Consumers and businesses benefit from predictability of charges. This is important within price control periods to minimise pricing risk being factored into retail pricing. It is even more important at the end and beginning of price controls as there is 'cliff edge' risk if there is structural change with the potential for significant impact. We would therefore seek assurances that mitigation, such as a 'glide path', is put in place if there is a significant material impact to enable businesses to plan ahead and adjust their business models. A way to achieve this would be to set the allowed revenues for the start of the new price control in a timely manner with reconciliation to the final allowed revenues after the go-live date. This would allow suppliers enough time to factor the step changes into contracts with their customers. As an example, in the last distribution price control, the revenues for the first year were set on initial proposals which were reconciled with the final proposals in the following year.

Within price control periods we would advocate advance notice of charges – 15 months for distribution, 12 months for transmission to reduce supply forecasting risks.

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

We support Ofgem's focus on 'whole system' costs as part of the regulatory framework. It is important that the network companies make effective trade-offs between distribution and transmission investments to meet needs as well as market based solutions and encouraging flexibility from users. We recognise the potential for flexibility to deliver real benefits in deferring or substituting costly asset-based solutions but, in the near term, these are likely to be localised and limited in potential.

At the same time a key part of RIIO2 will be the delivery of 'load related' expenditure. There are likely to be some material changes on the demand side over the coming period with increasing electrification of transport and heat, and on the supply side with growth in both decentralised generation and large-scale, low carbon generation. While there may be potential non-network based solutions to these challenges, RIIO2 will be key to support timely delivery of the network infrastructure needed to support Government policy. For instance there may be scope to improve the interactions between Ofgem's strategic wider works process, including network competition, and Government mechanisms to support deployment of large scale low carbon generation.

A key part of this review will also be to ensure that significant improvements in data and information sharing occurs between the network companies to recognise the significant growth in decentralised energy sources. It is particularly important for DNOs to share information with the ESO to allow them to develop the right tools to best balance and operate the system as a whole at least cost. These are key enablers to facilitate the delivery of a smart flexible energy system and lower costs and risks for consumers.

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

We do not see a need to align the start dates for the transmission and distribution price controls – this would create significant administrative burdens and risks delays to the delivery of important consumer reforms. If, through the whole systems work, it is identified that reforms are needed to the electricity distribution controls to fully deliver benefits then the issue should be reconsidered but even then we believe a form of workaround could be found for the two year period in question.

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?

- **Are there any implementation limits to this definition?**

For the purposes of network regulation under the RIIO-2 period, it is appropriate that the term 'whole system' is limited to (electricity and gas) distribution, transmission and the market-based solutions that may deliver the needed network capacity.

More generally for policy makers, whole system costs should refer to the full cost implications of different policy choices, including production costs, network investment and the cost of operating the whole system given these choices.

System Operator price controls

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

With the separation of the TO and SO, we consider it is appropriate that they have separate price controls so that the SO is fully decoupled under regulatory framework.

For the ESO we believe that this interim 3 year period in the run up to 2021 will give useful insights to confirm whether the current approach to ESO regulation, with challenge panel, forward work plan and broader incentives, is effective. In principle this approach appears to be a pragmatic way to balance incentives to mitigate short term costs while also encouraging broader forward thinking, and investment, to deliver medium term benefits for consumers.

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?**

We agree that it is appropriate to consider alternative remuneration arrangements for the ESO. RIIO-1 includes the ESO's price control for its internal costs, customer satisfaction incentives and various funds for innovation. With separation of the SO from the TO, basing the ESO's RIIO-2 price control on RAV will not work as the SO is an asset 'light' business. Alternative remuneration approaches should be considered from other jurisdictions and other sectors which support efficient costs and reward outcomes against robust and challenging performance metrics.

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

- **If so, why and what models? Network utilisation, stranding and investment risk**

We believe that the gas SO remuneration model does not need to change as there is relatively little change compared to electricity and the remuneration model has functioned effectively.

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?

RIIO-2 will be key to enable timely delivery of the network infrastructure needed for new build at both transmission and distribution level to support Government's low carbon energy policy and to maintain system resilience. Network companies will need to make a judgement based on best view at the time to deliver the required network capacity. This includes assessing whether alternative options such as active network management or the procurement of flexibility services at local level would better meet the requirements of users.

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?**

We do not consider it to be the role of network companies to be involved in direct contact with end consumers on energy efficiency savings, as this is not part of their regulated business. Additionally they do not have a customer services framework in place to deliver this. Our view is that further development of energy efficiency services should be undertaken through the market. Our views are further developed in our response to BEIS in their 'Call for evidence on building a market for energy efficiency'.

Chapter 5 - Driving innovation and efficiency Innovation

Innovation

We fully support the need for innovation to enable the transformation of the energy system and to drive down costs. We broadly agree with the proposal to use the incentives framework to move innovation into business as usual but to retain some dedicated innovation funding where it can be clearly justified where a project might otherwise not be delivered.

Competition

We support competition where there are clear consumer benefits. Our concern is that this may introduce a layer of complexity to whole system thinking and may result in a lengthy process, giving rise to uncertainty and risk in delay in connections.

Chapter 6 - Simplifying the price controls

We have no comments on this chapter.

Chapter 7 – Fair returns and financeability

It is important that Ofgem set a framework that delivers fair returns to network companies and ensures that these businesses are financeable. Network costs are a large part of the consumer bill and it is important that Ofgem bears down on these costs. In particular high returns must be justified by high performance.

Chapter 8 – Next Steps

We have no further comments.
EDF Energy
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