

RIIO-2 Framework consultation

RenewableUK response

May 2018

RenewableUK is the trade and professional body for the wind, wave and tidal energy industries. It promotes the deployment of clean energy in a smart energy system, by making politicians, the media and the public more aware of the UK's transition from fossil fuels to renewable sources. Formed in 1978, and with more than 400 corporate member companies, RenewableUK is the country's leading trade association working on the future of the electricity system.

This response has been compiled by RenewableUK with input from our membership. Our members employ a quarter of a million people and will invest more than £18.8bn in UK infrastructure between 2017 and 2021 – over 90% of which will flow to regions outside of London and the South East. In 2017, 28.8% of the UK's electricity was generated from renewable energy sources. 46% of this was generated by onshore and offshore wind, which provided 13.2% of the UK's electricity needs.

General principles

The UK's Climate Change Act requires our energy system to decarbonize in the 2030s. To achieve this goal, it is now widely accepted that the UK's energy system is moving to a smart, flexible, low-carbon network, with increasing volume of distributed generation, storage and consumer engagement. The RIIO-2 framework must enable this low-carbon transition at the lowest cost. This means:

- Investment and management of the UK's electricity networks should support greater penetration of renewable energy, via innovation in the management of the grid, particularly local systems management, storage, local generation to relieve constraint, and address local demand. This will be particularly important for the system operator, which should be encouraged to focus on technology neutral solutions to system issues.
- The whole system approach set out in the consultation paper should be truly that. Efforts should be made to secure the best outcomes for end users, who ultimately pay the network revenue. This may mean that more expensive solutions are found within a local area that delivers wider benefit for the system, or that solutions to grid issues in one area can be better resolved with works in another network.
- Network and system operators should have a clear set of outputs and customers should know what to expect.

Giving consumers a stronger voice

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

RenewableUK welcomes the proposal to have open hearings, engagement groups and user groups. The Framework Consultation document notes that the progress made on networks' engagement with consumer groups, and many companies have good relationships with the networks that they operate in. However, this is not universally true, and it is not always apparent how network users can engage formally with networks. Consumer groups, as described may provide network users with a formal route to engage with networks and scrutinize their plans. The sooner these groups are established, the better, and industry welcomes the early guidance issued by Ofgem on this.

Network management is complex, and scrutiny of business plans takes time and expertise. In the creation of consumer and user groups, Ofgem must ensure that Network Operators put in the time and resource to both recruit the right members with the relevant knowledge and expertise and provide the necessary support to them. Network operations will need to publish business plans which are clear enough for these groups to assess, as well as other network users to properly scrutinize and feedback on.

The RIIO-2 Challenge Group itself will have a huge amount of information to assess, and we welcome the commitment from Ofgem to provide this group with the resources it needs. Within this Group's remit must be the requirement to assess the delivery of not just sustainability, but the whole system objective of decarbonisation, and overall long-term value for end users.

Responding to changes in how the networks are used

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 innovation or efficiency grounds?*

RenewableUK supports the proposals for a five-year price control. The consultation document rightly notes the pace of change in the system. Between 2021 and 2028 we can expect to see huge change on the system, and this will need to be reflected in the way the system is regulated. We cannot envisage specific circumstances where longer price controls may be necessary, but would be open to this if a good case is made. However, when this does occur, it is important that these are reviewed regularly, and targets rebased against the wider framework, keeping the long-term and whole system needs in mind. Similarly, non 5-year portions should be limited to ensure that customers' ability to scrutinize everything is not limited, and the whole system approach is not impacted. Shorter price controls make more sense to an extensive Mid-Period Review. However, greater clarity is needed on what an extensive MPR may entail as it could to increase uncertainty in planning, raising capital costs for both networks and users.

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

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?*

The Climate Change Act underpins the move to a low-carbon, flexible system. Barriers to achieving this include:

- Speed at which renewable generation can deploy and connect to the distribution and transmission networks
- Constraints on the system restricting the System Operators ability to draw on all low carbon resources (e.g. at the Scotland/England border)
- Lack of opportunity for renewable technologies to compete in technology neutral capacity and ancillary markets.

Some of these issues are being addressed, for example, through National Grid's SNAPS programme and investment in the Western Link, but decarbonisation of the electricity system needs to happen more swiftly. Whole system approaches and network incentives should explicitly support a grid carbon intensity that is aligned with the fifth carbon budget. It is worth noting that the beginning of the fifth carbon budget coincides with the end of the proposed 5-year ED-2 price control and therefore a huge amount of change will have to be delivered within the RIIO-2 control period.

While sustainability features in the RIIO-2 Framework Consultation document, there needs to be a stronger reference to this, making it an explicit goal in of network investment and whole system outcomes. Low-carbon technologies are now the cheapest form of generation and can supply a range of system services, including Black Start, inertia and frequency response. The SO should be encouraged to develop their markets to ensure that all technologies can compete within the system.

Distribution and transmission operators should continue to be encouraged to share proposals and plans for network developments. As the system becomes more decentralised, with increasing volumes of local generation, it may often be the case the issues on one part of the network could be more efficiently relieved by action by another network operator. Distribution and transmission network operators should continue to be incentivised to find the cheapest solution for the end-user, rather than for just their network.

As the move towards smart systems progresses, there is the potential more many different models and approaches to develop. RIIO-2 should support the standardization of practices across networks, so that network customers in different regions do not have to deal with many different regimes.

In the long-term, the decarbonisation of the economy will mean greater interaction between the gas, electricity and transport networks – for example, through the displacement of gas by electricity for heating, or by the use of electricity for generation of hydrogen as well as charging of electric vehicles. Whole system outcomes therefore require greater communication and coordination of efforts between gas and electricity network operators as well the government's transport strategy.

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?*

Yes. While it would be useful for the price controls to be aligned to deliver more efficient outcomes, this may distract networks from more urgent work that should be prioritized.

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

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

We agree that with the legal separation of the SO from the TO, they should have separate incentives and price controls. A revenue support model for the SO should incentive the delivery of a lowest cost provision of services. For instance, revenues should not be linked to the totals costs of the services procured through the balancing mechanism and other system services, but the development of efficient markets.

Having said that, Ofgem will need to ensure that costs for the transmission and system operators are considered for their whole system impact. Reduced investment and costs in the Transmission System could translate to higher costs for constraint by the System Operator, and consequently unacceptable increased in Balancing services use of system (BSUoS) charges.

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 is important to avoid stranded assets, and associated costs to consumers where possible. However, with the system rapidly changing is it impossible to be entirely certain where these will be. A worse outcome would be to delay the transition to a flexible system, which will deliver consumer benefit and our carbon budgets. Solutions that free up network constraint should be executed in a timely manner and could be supported by competitive time of use pricing signals. These will further support flexibility on the system and changing consumer patterns – e.g. in the form of competitive EV tariff or reward mechanism to encourage consumers to use electricity when it is not needed.

Driving innovation and efficiency

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?*

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)?*

Funding for innovation should be directed at development of projects that will support the development of a low-carbon, smart, flexible system. Funding should not be provided for projects that will simply improve efficiency (e.g. drones for inspection of cables). These projects should be a part of networks' business as usual, and should be incentivized by the need for efficiency. If an innovative technique is introduced by one Network Operator and can be used by another, this knowledge should be shared. The same innovation should not be rewarded more than once.

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

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

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

We welcome greater use of competition, where this makes sense. Competition can find more cost-effective solution to a particular problem. In assessing cost-effectiveness, it is essential that this is considered in the context of the final bill payer, not just network costs.

Extending competition also raises questions about who is and should be responsible for managing network issues and on what basis these competitions should be run. Whole system outcomes should be the most important factor. For example, and DSO may run a competition to address network constraint, with various solutions such as network reinforcement, storage or distributed generation coming forward. These would all have very different impacts on the network infrastructure, its management and, ultimately, cost to consumer. Only in the first case would be the ongoing role of the network/system operator to manage, increasing the asset base and asset revenues, but storage may be the best solution from a whole system approach.

Where revenues are related to assets, there is a risk of focusing on reducing costs of assets, without assessing the associated impacts on value for money in the longer term. Ofgem should focus as much on the longer-term value of an asset or product as they do on driving down costs through competition. The consumers of tomorrow should not be penalised for outcomes which do not offer longer term value for money, but instead merely offered short-term cheapness for the consumers of today.

Ofgem should consider extending competition into the design and build of network infrastructure below the £50m threshold to bring down the costs of network development. However, ownership of these assets should still remain with either the network operators, or generators where appropriate. We would warn against extending the OFTO model of network ownership into other areas of the network. The OFTO regime has loaded risk and cost onto offshore developers and generators, without them having the ability to manage either of these. This risk raising the cost of capital for future OFTO-connected projects, and ultimately the cost of energy for consumers.

Simplifying the price controls

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

It is difficult to comment these until Ofgem has proposed what the criteria might be. In working with networks, RenewableUK members have faced challenges that result in poorer outcomes. This has been most noticeable in the time take to get grid connections. The work of the Charging Futures Forum may have an impact, particularly in regard to how generators approach access issues, which may have an impact on demand and how networks deliver grid connections. Ofgem should consider the progress of the CFF as part

of their work on setting outputs and incentives. Given the rapid change on the electricity network, there will need to be some flexibility in the price controls, particularly for the system operator, to ensure that new technologies and developments can be deployed rapidly for the benefit of end users.

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

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

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?*

We welcome proposals to address our performance. Investors in the energy networks should expect similar returns to other long-term infrastructure investment.

Fair returns and financeability

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?*

Targeting the cost of debt for a comparable infrastructure company is a reasonable approach. The framework consultation rightly notes the importance of balancing costs for consumers and risk.

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?*

The CEPA analysis is a robust independent assessment of the cost of equity and we see no reason to dispute its findings.

While delivering energy networks is complex, and subject to a great amount of change over the coming decade, it is also regulated monopoly industry, with regulated returns, and therefore relatively secure investment. With this in mind, it is reasonable that there is a return on equity in line with similar industries, but reflects the lowered risk/return profile.