

RIO-2 sector specific methodology consultation

Consultation response

March 2019

This is a response to the RIO-2 sector specific methodology consultation. Our answers refer to the sections on whole system outcomes, the ESO, managing risk of stranded assets and competition questions. The response has been compiled by RenewableUK with input from our membership.

RenewableUK is a membership body with a mission to build our future energy system, powered by clean electricity. We bring them together to deliver that future faster; a future which is better for industry, billpayers, and the environment. We are a UK membership body with a mission to ensure increasing amounts of renewable electricity are deployed across the UK. We support over 400 members to access UK markets and to export all over the world. Our members are business leaders, technology innovators, and expert thinkers from right across industry.

Together, our members employ a quarter of a million people and will invest more than £20.6bn in UK infrastructure between 2017 and 2021 – over 90% of which will flow to regions outside of London and the South East. In 2017, 29.3% of the UK's electricity generation was from renewable energy sources. 52% of this was generated by onshore and offshore wind, which provided 15.5% of the UK's electricity needs.

Enabling whole system solutions questions

CSQ8. Do you feel we have defined the problem correctly?

Ofgem has recently consulted on introducing changes in the network licences to adopt whole system thinking. As part of our response¹ to this consultation we highlighted the need to make specific whole system provisions within the RIO-2 framework which will build upon the requirements to coordinate economic and low-carbon networks.

The problem as stated in the consultation is broadly defined correctly – networks investing without regard to the wider system needs will result in sub-optimal outcomes. The lack of coordination of activity between traditional system boundaries is predominately a result of a lack of information which is not readily available as well as the need to change behaviours and company practices that are not forthcoming, rather than lack of incentives or price control processes that hinder it.

CSQ9. What views do you have on our proposed approach to adopt a narrow focus for whole systems in the RIO-2 price control, as set out above?

¹ Attached with the response to this consultation.

and

CSQ10. Where might there be benefits through adopting a broader scope for some mechanisms? Please provide evidence.

RenewableUK does not support the proposed narrow focus approach for whole systems in the RIIO-2 price control.

Collaboration between gas and electricity networks could become increasingly important with the emergence of more hydrogen networks across the country. Earlier this year, the Committee on Climate Change² recommended that from 2025 onwards all new homes should not be connected to the gas grid and should instead rely on electrical systems for heat and cooking. This will have very significant implications for heat decarbonisation as well as the future of the electricity networks towards the end of the RIIO-2 price control. Network operators could play an important role in furthering the electrification of heat and transport through cost efficient grid reinforcement solutions that incorporate whole system thinking. A broader scope will also allow for the consideration of whole system benefits to consumers from the wider adoption of low emission, hybrid or electric vehicles.

We would also note, that because distribution companies are not considered as part of this sector specific consultation, there is a risk that whole system benefits are not appropriately assessed. The outcomes of the Electricity Network Access Project and the DSO licence arrangements, defining the roles and responsibilities of the future DSO, may have significant impacts to the ESO and the electricity TO funding model. Ofgem should ensure the RIIO-2 price control framework is flexible enough to adjust for this uncertainty.

CSQ11. Do you have reasons and evidence to support or reject any of the possible mechanisms outlined in this chapter? Do you have views on how they should be designed to protect the interests of consumers?

CSQ12. Which of the possible mechanisms we have outlined above could pose regulatory risk, such as additionality payments or incentivising the wrong behaviour?

and

CSQ18. Which of the proposed mechanisms would be most suitable in circumstances where a broader definition of whole system is likely to deliver benefits to network consumers?

RenewableUK supports the whole system incentive mechanism focused on innovation in combination with the coordination and information sharing incentive.

Strategic innovation activities linked to the energy system transition across gas and electricity is the right tool to encourage a sector-wide whole system approach. There is scope to include a whole system consideration as part of the proposed wider reform of the current innovation package. A specific coordination and information sharing incentive will also improve visibility between traditional system boundaries and the current process of options assessment between TOs and DNOs in particular. As noted in the consultation document, the Network Access Policy (NAP) already covers effective exchange of

² Committee on Climate Change, 'UK housing: Fit for the future?', February 2019
<https://www.theccc.org.uk/wp-content/uploads/2019/02/UK-housing-Fit-for-the-future-CCC-2019.pdf>

information on planning and outages within the transmission network but there is no similar mechanism for cross boundary cooperation.

With regards to the rest of the proposed mechanisms, we are concerned that price control re-openers will be difficult to identify and might not incentivise the right behaviour (e.g. a whole system solution is identified but it is not pursued as it cannot meet the financial threshold to trigger a price control re-opener). At the same time a business plan incentive might be difficult to assess, reward and penalise correctly and it will require a consideration of baseline expectations for meeting a whole system ambition. This might not drive the right behaviours, with companies being encouraged to meet the baseline expectations or risk non-delivery if the penalty for underperformance is less than the benefit of carrying out whole system commitments.

Ofgem needs to assure that the Interest of Consumer test is robust. The relative narrow focus for whole system should take into account the long-term interests of current and future generations as underlined by decarbonisation targets and in line with Ofgem's statutory duties.

CSQ17. Are there any sector specific whole system barriers or unlocked benefits, and if so, any sector specific price control mechanisms to address these?

No comment.

Managing the risk of asset stranding questions

CSQ39. Do you think there is a need for a utilisation incentive at the sectoral level? If so, how do you think the incentive would operate coherently with the proposed RIIO-2 price control framework for that sector?

A specific asset utilisation incentive might not be needed, if a whole system incentive mechanism is introduced encouraging greater information sharing across traditional system boundaries, including information about system requirements and network reinforcement.

Nevertheless, there will be a need to monitor asset utilisation while ensuring network companies size their assets appropriately. Currently the totex incentive rewards companies for effectively managing system requirements; however, the mechanism does not track the success of utilising existing assets. The tests for success should be clear measurable system targets where the uptake of non-fossil fuel based flexible energy services and technologies is obvious. For this reason, while we recognise license conditions place obligations on networks, we believe these have to be complemented by the introduction of a specific target for improved network asset utilisation. This could be achieved either via the introduction of a capital efficiency target or by making the ratio between maximum capacity and the average load on a network a primary metric for adjusting network company revenues. The assessment should be applicable to generation and demand led constraints.

We note the potential increase in network technical losses as a result of increased utilisation and Ofgem should consider addressing the Losses Incentive to counter-balance the greater consumer benefit from reduced network investment.

CSQ40. Do you have any views on our direction of travel with regard to anticipatory investment?

We support the view that nearly all network investment should be considered anticipatory as it is undertaken ahead of a need. The Flexibility Commitment³ which will see distribution network operators open up requirements for new network infrastructure to include flexibility service providers, will have significant implications for electricity transmission. This could be an essential component that allows a 'systems wide' perspective to be taken and will need to be factored into any future options assessment and consumer benefit from network investment.

Competition questions

CSQ51. Have we set out an appropriate set of models for both late and early competition to explore further?

RenewableUK considers that the models identified for late and early competition are appropriate. We agree with Ofgem's assertion that early competitions, particularly in electricity distribution, could produce benefits for consumers by revealing new or innovative ways of solving network problems (such as grid constraints) and avoiding expensive reinforcement costs by opening up network requirements to flexibility providers.

CSQ60. Do you agree with the criteria we have set out for assessing who should run competitions? Based on these criteria, which institution do you consider is best placed to run early and late competitions?

In general, RenewableUK agrees with the criteria set out in the consultation. We also agree with the proposed institutions who are best placed to run early and late competitions. We note that whenever possible, communication about tender design should be presented as accurately as possible especially in cases where it relates to grid constraints.

CSQ62. How do you think competition undertaken by network companies should be incentivised? Is the use of totex the best approach? Will this ensure a level playing field between network and non-network solutions including the deployment of flexibility services?

No comment.

³ ENA, 'Energy Networks Association's Flexibility Commitment', December 2018
<http://www.energynetworks.org/assets/files/ENA%20Flex%20Committment.pdf>



ESO Framework

ESOQ1. Do you agree with our proposal to maintain the current roles and principles framework for RIIO-2?

and

ESOQ2. Do you agree with our proposals to keep the ESO's code administration, EMR delivery body, data administration, and revenue collection functions in place for RIIO-2? Do you believe that any of these functions (or any other functions) should be opened up to competition, either now or in future?

RenewableUK considers that the roles and principles set out by the current framework for the ESO should remain.

With regard to the specific ESO function, we do not believe the current regime would benefit from opening any of those functions to competition. However, if there is significant evidence that there is a conflict of interest or poor performance Ofgem should consider whether there is merit in opening these functions to competition.

ESOQ3. Do you consider the ESO is best-placed to run early and late competitions?

Please refer to our answer to CSQ60.

ESOQ4. Do you agree with our proposal to move to a two-year business planning cycled price control process for the ESO? If not, please outline your preferred alternative, noting any key features (e.g. uncertainty mechanisms or reopeners) that should be included.

RenewableUK does not agree that Ofgem has presented enough evidence in support of the two-year business planning cycle price control. We have strong reason to believe that a bespoke two-year price control for the ESO might perversely incentivise the ESO to focus predominately on the short-term and limit the scope for long term planning.

The ESO needs to be incentivised to make long-term commitments which could deliver greater consumer benefits and provide the necessary certainty of transmission that connected projects need when making investment decisions. A two-year price control will limit the ESO's ability to provide forward-direction to the industry which will add to the risk to projects ultimately passing those costs to the end-consumer. As a general principle, pricing incentives should avoid short-term value being prioritised over long-term efficiency, which would undervalue the role of flexibility. We would be more supportive of the introduction of a five-year business planning cycle price control with uncertainty mechanisms built-in to allow for the necessary flexibility in ESO activities.

Lastly, we would like to note that a two-year price control will introduce quite a heavy regulatory burden on Ofgem, the ESO, as well as the wider industry making the whole process resource intensive.

ESOQ5. What stakeholder engagement mechanisms should be put in place for the ESO's business planning and ongoing scrutiny of its performance? Do you agree with our proposal to maintain, and build upon, the role of the Performance Panel?

RenewableUK agrees with Ofgem's proposal.



ESOQ6. Do you agree with our proposed approach of using evaluative, ex-ante incentives arrangements for the ESO?

And

ESOQ7. Do you agree that we should continue to apply a single ‘pot’ of incentives to the ESO, and that this should be a symmetrical positive/negative amount? If not, why not?

RenewableUK is concerned that if retained, the framework’s ex-post incentive approach will need to be reviewed. The current definition of meeting and exceeding the baseline, adopted in the last ESO Forward plan for 2019-21⁴, is too subjective making it difficult to justify which activities are considered to meet or exceed the baseline expectations.

We have strong reasons to believe that the current evaluative scheme is not clear about what success looks like and how it will be rewarded. It is not as effective at driving the ESO’s behaviour as a more targeted scheme could be. We would be more supportive of a targeted incentives scheme with a clear definition of success to drive the ESO and to deliver benefits beyond baseline expectations as well as plan for the long term.

ESOQ8. Do you agree with our proposed approach to assessing the costs of the ESO under RIIO-2? Do you think we should assess costs on an activity-by-activity basis? How would you go about defining the activity categories? Are there alternative approaches we should consider?

And

ESOQ9. Do you consider the types of cost assessment activities we outline in this chapter are the right ones? Are there additional activities you think we should consider?

Broadly the proposed activity-by-activity approach and the cost assessment activities reflect the ESO roles and responsibilities well.

ESO Finance questions [ESOQ10 – ESOQ13]

A revenue support model for the ESO should incentivise the delivery of a lowest cost provision of services. We note that the revenues should not be linked to the totals costs of the services procured through the balancing mechanism and other system services, but rather through the development of efficient markets.

ESOQ14. Do you agree with our proposals to retain an innovation stimulus for the ESO, but tailor aspects of this innovation stimulus to take account of the nature of the ESO business?

And

ESOQ15. What ESO-specific issues should we consider in the design of the ESO innovation stimulus package

⁴ ESO, ‘ESO Draft Forward Plan 2019-2021’, January 2019
<https://www.nationalgrideso.com/document/136036/download>



A tailored innovation funding for the ESO might be the right solution. A reformed RIIO2 innovation package targeted at the energy transition challenge and greater third-party engagement in innovation projects will provide the ESO with access to innovation stimulus funds. It might also include a specific pot for joint innovative projects on a whole system basis. As the ESO framework already features a specific whole system objective there is a risk of conflict between innovation and incentives which could increase cost to consumers if not properly designed. Thus, we would be more supportive of tailored innovation funding which recognises the bespoke nature of the ESO role and price control.

We are also supportive of the proposal to recover ESO innovation costs through BSUoS rather than TNUoS as we consider that this will bring greater alignment to the way ESO internal costs are currently recovered through BSUoS.

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