Greater South East Energy Hub - Ofgem RIIO open letter consultation response

Overarching objective – "to ensure that the DNOs deliver the value for money services that both existing and future consumers need."

Main priorities to help carry out our principal duty to protect the interests of existing and future consumers:

- Decarbonising to fight climate change at the lowest cost to consumers;
- Enabling competition and innovation, to help increase efficiency; and
- Protecting consumers, especially the vulnerable.

Response

Greater South East Energy Hub response to Ofgem's 'Open Letter Consultation on approach to setting the next electricity price control (RIIO-ED2)'

I am writing to set out the Greater South East Energy Hub's response to the above consultation.

The Greater South East Energy Hub is a collaboration of 11 Local Enterprise Partnerships covering 148 Local Authorities. As part of our research we have received responses from our stakeholders, some of which intend responding directly to this consultation. Where we have been asked to represent their views we have endeavoured to do so. However, all views here represent those of the Greater South East Energy Hub only.

1. **Do you have any views on the proposed objective for RIIO-ED2?**
   We generally agree with the overarching objective and the main priorities. We feel however, that reference to consumers does not reflect the wider range of stakeholders that is emerging, moving away from the traditional consumer-only model to include prosumers as well as community-based investors.

   Whilst we understand the need to keep bills as low as possible, particularly for those in fuel poverty, the current restrictions on DNOs forward funding infrastructure to support future growth need to be reviewed. We would request that the proposed key objective for RIIO-ED2 needs to better acknowledge the role which DNOs should be playing in supporting future capacity requirements.

2. **To what extent should we consider outcomes linked to decarbonisation targets, and what outcomes might this involve?**
   The investment ahead of need principle is a valuable tool to minimise unnecessary expenditure. However, that principle is a barrier to change whether that is due to the decarbonisation of heat and transport or local growth. A better understanding is needed of monitored network performance alongside intelligence about future demand that will be placed on the network.

   A managed approach is required including designing, investing in and operating the network with decarbonisation in mind – bringing forward reinforcement to enable distributed generation on an intelligence led basis. This will reduce the need for flexible connection zones and requires investment in real-time monitoring and active management technologies. Making real-time network performance information accessible to assist third parties who may be looking to invest in solutions will help in developing shared investment

models that can deliver value - actively promoting local solutions that maintaining frequency and voltage levels.

In summary, the investment ahead of need principle and the lack of real-time, openly accessible data is a major barrier to long term investment in the grid network.

3. **Are there activities that DNOs are best placed to carry out in order to achieve these outcomes?**
   DNOs are best placed to manage network performance using real-time monitoring systems. The sharing of that information could be a DNO function, although not exclusively since it may be valuable to be able to embed the data within other data and information sharing platforms to improve understanding and planning of third-party investment in new distributed energy resources.

   What are the alternatives?

   We consider that alternative investment models, for example a shared risk and return, could create opportunities for wider network improvement without burdening the energy consumer. This would reduce the potential cost burden on the consumer.

4. **How should we assess DNO funding requirements and measure DNO performance in these areas?**
   Decarbonising to tackle climate change is currently not addressed explicitly through the funding assessment. We propose, therefore, that the assessment includes a metric that can demonstrate either actual or enabled carbon reduction. In this way, improvements that will facilitate third party investment in technologies and techniques that secure decarbonisation can be recognised alongside network improvements that actually deliver carbon savings.

5. **How should we incentivise DNO performance when the achievement of outcomes could be dependent on the actions of others?**
   Currently the DNO does not actively promote areas of the network that may be suitable for Distributed Energy Resources; they have, however, started developing their flexible services offer whereby some are procuring flexibility where there is significant constraint. The DNO could be tasked with actively engaging with potential participants to stimulate the installation of new generation or storage. The DNO performance could then be rewarded according to their success at reducing imbalance or increasing locally connected generation and storage.

   This point has been raised by the Isle of Wight Council who have believe here is a need for the regulator to require DNOs to take a different approach, to facilitate new renewable generation through services such as demand turn up, rather than the current approach where they are neither incentivised for connecting generation nor penalised if they make it virtually impossible. Otherwise it will remain a low priority with the focus on load connections.

6. **How do we ensure that network companies are best placed to undertake strategic investment and manage the associated risk?**
   A shared risk model with investors who have a stake in the locality, for example the Local Enterprise Partnerships, local authorities or the local community could enable strategic

investment where currently the investment ahead of need approach is restricting all but the most evident business cases to be included in the agreement.

How can we improve strategic investment?

DNOs could be required to work directly with Local Authorities in order to more accurately predict future need. This will help DNOs to plan effectively and reduce the fog caused by speculative enquires. Presently Local Authorities are having to pay DNOs to predict future need, when it should really be viewed as a core activity.

How should the risks of these investments be managed?

This could work in a variety of ways; an example could be that the DNO manages the network asset on behalf of the investor until such time as the need is close to or has been met at which point the DNO can then take ownership. As connections (new or enhancement to existing) are made, the DNO buys the asset from the investor by using the fees that have been accrued.

7. **What, if any, changes to the framework are required to support strategic investment?**
   We have no view at this time.

8. **How should we hold the companies to account for the delivery of strategic investment, and the outcomes that they are expected to deliver?**
   We consider that Ofgem should in the case of vulnerable customers for example, extend the scope of the Stakeholder Engagement and Consumer Vulnerability Incentive through the use of a stakeholder panel model. In this way, Ofgem would be better placed to hold the senior management of DNOs to account in their response to dealing with customer vulnerability.

   Currently, there is no mention of de-carbonising the network in the current incentive, and this should be made one of the key measurements of any incentive/sanction mechanism.

9. **Is there a need to separate out the revenues and outputs for 'traditional' DNO functions from DSO functions? How could this be achieved?**
   We do not feel that there is any merit to separating out the functions as long as there is a robust plan, monitoring and performance management framework within which the transitioned function is managed.

10. **In the event of the DSO function being delivered by a separate party, how might we determine the revenues for DSO activities? What type of funding model would be appropriate to set DSO revenues? In this event, would changes also be required to DNO revenues and outputs?**
    See our previous comments at Q9.

11. **Where a DNO is undertaking a DSO function, what type of outputs or outcomes are necessary to measure how efficiently they are performing this function? Over what time period could these be measured?**

There are a number of key metrics that would help a wider range of stakeholders engage with DNOs including:

- Quality of network monitoring and availability of good quality, real-time data throughout the voltages including the spread of coverage
- Changes to the application process to recognise applicants who are bringing forward active network management solutions – e.g. reduced application costs and a simplified process for smaller installations such as with Vehicle to Grid
- Actively promoting active network solutions including low carbon generation

12. In what ways could the existing arrangements drive more innovation and competition?

- Unlikely to do so given that DNOs are not allowed to invest ahead of need or actively promote such solutions

13. To what extent should we set (and incentivise performance against) baseline totex allowances for activities where flexible solutions could be provided?

We have no view at this time.

14. Should we instead set allowances based on the costs revealed through the flexibility tendering process? How might this work?

Views expressed by some attending recent flexibility events has voiced concerns that tendering process appeared to favour incumbents in the market over smaller participants due to its one-size-fits-all process. The process needs to be made easier for new entrants and investors by reducing the complexity of the process. Longer term contracts will allow them to be able achieve equitable returns on investment.

15. To what degree should DNOs modernise their handling practices to adhere to data best practice, and therefore (among other things) provide available, transparent, and interoperable data about their networks? What measures will be needed to ensure data remains secure?

Many of the key points raised within this question are covered by the findings and recommendations contained in the Energy Data Task Force report, including:

- with digitalisation
- a presumed open principle
- publication of a data catalogue and infrastructure/asset inventories; and
- a data accessibility strategy be written into the RIIO ED2 agreement.

Further stakeholders should be engaged to establish an open data access forum with a policy of data exchange for the wider benefit of society; and cross-sectoral data and information aggregation through an independent national data host in a form that benefits longer term challenges e.g. energy trilemma, clean growth, net zero carbon.

16. **How should we structure RIIO-ED2 to encourage metadata to be made available, and for data to be presumed open? How should we measure DNO performance in this area, and on what basis should funding be set to deliver relevant outcomes?**

Measurement outputs could include scale network coverage, currency of data made available and stakeholder interoperability. Outcomes could impact on network performance

and cost of delivery. Funding arrangements could use the similar incentive-based approach to stakeholder engagement and vulnerability.

17. **Do you agree with the themes we plan to include in our guidance on data best practice?**
In general, we agree with the themes proposed, although it is important to ensure that a wide range of stakeholders are engaged with the design principles of data management arrangements – in order to ensure that what is captured is in formats that allow maximum value to be extracted from the information.

18. **We welcome views on our proposed position of a five-year price control for RIIOED2.**

We welcome the move to a 5-year price control period. We would further welcome active engagement with those organisations in the public sector who are involved in the shaping of places (e.g. Local Enterprise Partnerships, Planning and economic Development functions of local authorities) so that intelligence is shared, and all parties can take account of collateral impacts.

Further we note RIIO2 and subsequent price control periods do not directly translate to the 5-year UK carbon budgeting periods and would advocate a stronger relationship between the setting of UK carbon reduction targets and future RIIO agreements.

19. **Are there any elements of RIIO-ED2 price control that we should consider setting over a longer or shorter period? Please give reasons.**
For the reason set out in our response to Q18. We would welcome trajectory setting across future RIIO price control period up to 2050, stepped at 5-year intervals.

20. **We welcome views on whether these enhanced engagement arrangements are appropriate for RIIO-ED2.**
See comments made in our response to Q8.

21. **We welcome views on whether the proposed output categories and incentive arrangements are appropriate for RIIO-ED2.**
See comments made in our response to Q.8 on extending incentivisation to network de-carbonisation.

22. **We are interested to hear if there are new elements of the services DNOs will need to deliver that should be included in the current output categories. Alternatively, we welcome views on whether these should be captured by a new output category. For these new elements, we are interested to hear how delivery of these services should be valued and measured.**
See comments made in our response to Q.8 on extending incentivisation to network de-carbonisation.

23. **We welcome thoughts on how to ensure that we continue to protect the interests of vulnerable consumers, particularly in light of the energy system transition.**
One option to support vulnerable customers would be extending the Safety Net principles for vulnerable customers obliging network operators.

However, we do recognise that the undoubted need for additional infrastructure spending will lead to increased DNO costs. While these improvements will enable economic growth and help mitigate against future climate related expense, the short-term cost to the fuel poor should be planned for in advance.

The Warm Home Discount provides a buffer against winter expense for those in fuel poverty, and work is underway to expand the 'core group' of recipients using data matching under Part 5 of the Digital Economy Act. We believe that rather than being linked to inflation only, the metric for increasing Warm Home Discount payments could factor in increases to DNO costs. This will likely require increased direct spending by BEIS, but via general taxation the cost will fall more broadly on those 'able to pay'.

The International Monetary Fund, Fiscal Monitor report 'How to Mitigate Climate Change' (October 2019) identifies international and domestic fiscal policy and ambitious carbon taxes on fossil fuels as the most effective and efficient mechanism to mitigate climate change and provide revenues to support the transition to cleaner energy whilst maintaining economic growth and creating jobs. The report cites a carbon tax floor price of $75/tonne CO_2 by 2030 to meet 2015 Paris agreement target of a 2°C rise in global temperature. The allocation of revenues generated through carbon pricing could include investment in clean energy infrastructure, market failures and impediments (e.g. network externalities and market distortions) and assistance to low income households.

24. **We welcome views on how DNOs should continue to ensure their networks are resilient, particularly in the context of the new or changing way assets are used.**
As previously discussed, we consider that changing to a model of investment ahead of need could encourage a long-term interest in resilience, as well as decarbonisation, to reduce network vulnerabilities and facilitate clean growth.

Through this wider investment perspective beyond DNO shareholder value, clean economic growth could be accelerated, facilitating benefits for others like small and medium-sized enterprises who currently cannot afford expensive grid reinforcement costs.

25. **We are interested to hear stakeholder views on how DNOs should ensure their networks are resilient to physical and/or virtual threats, as well as being able to withstand the effects of adverse weather and the impacts of climate change.**
Building in flexibility and local resilience should in turn facility resilience at higher voltage. DNOs should be actively engaging with stakeholders with an interest in building a more robust network, create simpler and more transparent forward planning mechanisms and investing at the appropriate time within the RIIO-ED2 price control period for the benefit of the local area that the improved part of the network will serve.

26. **We would also like to hear how stakeholders believe climate change mitigation and adaptation may affect network maintenance and development in the short, medium, and long term.**
We consider that the transition to a more distributed, actively managed network and the increased diversity of energy resources in the network, although increasing its cost, should strengthen the network against unexpected shocks as exemplified by the recent outages of the Hornsea offshore wind Farm and Little Barford Gas Power station.

Mitigation –through the DSO model and working with local partners to allow shared investment in technologies which enable resilience e.g. battery storage

Adaptation – if DNOs actively managed a smart energy grid, with appropriate storage solutions, then they would have a greater ability to manage situations such as the over production of Solar PV during certain summer days

Suffice to say having diversity of resources in the local network could be viewed as a means of managing short term disruption to the network. Events like the Little Barford gas-fired station drop out highlighted the need for more 'synthetic inertia' on the network.

27. **We would like to hear views on how we ensure DNOs remain resilient to the challenges presented by an ageing and changing workforce.**

    We have no comment to make at this time.

28. **We welcome views on how DNOs should work to minimise the impact of what they do on the environment and facilitate the transition to a low carbon energy system. We are particularly interested in the implications of the government's updated target of net-zero emissions by 2050.**

    In its report to Government, which led to the Government committing to the net-zero 2050 target, the Committee on Climate Change concluded that:

    "when grid capacity is increased, this is to a sufficient level to avoid having to upgrade the capacity again prior to 2050 . . . a relatively large expansion in capacity is likely to have low regrets, 'future-proofing' the network to enable greater electrification if necessary and/or enabling demand to respond more readily to variations in Low-Carbon electricity supply."

    Our research and experience across the distribution networks in the South East reveals that the policy of planned re-enforcement and not being able to invest ahead of need is likely work contrary to the Committee's view.

    We would advocate, as we have previously stated, developing more flexibility to allow investment in improved and new capacity working with other actors in the areas where network conditions are hampering clean growth.

29. **We also welcome views on what this may mean for the type of activities networks undertake, how these may be funded, as well as the outputs and/or incentives they should be exposed to.**
    We refer to our previous responses.

30. **Finally, we are keen to understand how DNOs' performance should be measured, and how we should assess the value that consumers place on the provision of these services and activities.**
    The challenge is that the DNOs have little visibility with end consumer's hence this hampers understanding about their key role now and in the future as they progress towards becoming DSOs. Further efforts need to be made to build understanding and appreciation of

the value of a resilient, affordable and decarbonised energy system to the future of our communities of which a power network which enable this transition is critical. Research commissioned by UKERC highlighted that the public, when provided with an informative and well-argued explanation of the implications of not investing in the energy system are prepared to accept some of the cost should fall to the consumer if they can see that major players in the energy sector profiting unreasonably.

The challenge for Ofgem is to ensure pricing arrangements that protect the most vulnerable while helping to facilitate

31. **We welcome views on how RIIO-ED2 can best capture the benefit of whole systems solutions. We are also interested in views on how these benefits should be measured.**
We agree with the rationale to capture and measure whole system solutions and benefits (when defined) and note that it could be subject to future review.

However, in order to express a clear view we require further information on what a whole system solution encompasses in this context and the associated benefits.

32. **We further welcome stakeholders' opinions on whether the electricity distribution sector's approach to whole systems should be different from the other sectors and, if so, why.**
As with Q31 above we require more information about what constitutes a whole system solution in order to express a clear response.

33. **We welcome views on how we should manage the uncertainty associated with forecasting allowances, and whether there are any mechanisms we could or should consider in helping to manage this uncertainty.**
We have no comment to make at this time.

34. **We seek views on the use of indexation, particularly on any adjustments for labour and construction cost inflation.**
We have no comment to make at this time.

35. **We welcome views on our approach to highly anticipatory investment projects. We are interested to hear whether stakeholders would suggest additional processes or regimes for facilitating such investments that support the energy system transition whilst protecting consumers from potentially inefficient investments.**
See our response to Q.6.

36. **We welcome views on the type of issues that should be considered through an interinstitutional group.**
We have no comment to make at this time.

37. **We invite stakeholders to advise what type of expenditure they believe should be subject to alternative arrangements for sharing risk, and what these arrangements may look like.**
See our response to Q.6.

38. **We welcome views on the proposed innovation stimulus. We are interested to hear views on the types of projects that should be funded through either the NIA funding or a new funding pot.**
    We have no comment to make at this time.

39. **How can the benefits of the innovation stimulus be maximised by supporting schemes proposed by non-network parties?**
    We have no comment to make at this time.

40. **We also welcome views on our proposals for the different competition models in RIIO-ED2, and what, if any, criteria should be set out for the use of early or late stage competition models.**
    We have no comment to make at this time.

41. **We also seek input from stakeholders on how native competition obligations and best practices can be used to ensure the best outcomes for consumers and to drive changes in the role of the networks in a transforming energy system.**
    We have no comment to make at this time.

42. **We welcome views on our approach to planning, forecasting and scenarios for RIIOED2. In particular, do stakeholders have other suggestions as to how we can best manage forecasting risk for consumers?**
    We have no comment to make at this time.

43. **We welcome views on our proposal to remove the early settlement process for RIIOED2, instead focusing on alternative mechanisms to receive high-quality and ambitious business plans.**

    We have no comment to make at this time.

44. **We also welcome views on our proposals to use the Business Plan Incentive and the confidence-dependent incentive rate arrangements for RIIO-ED2. In line with this, we are interested to hear stakeholder views on the range that should be used for both of these.**
    We have no comment to make at this time.

45. **We welcome stakeholder views on our proposals to introduce measures to enable network companies to finance their activities whilst ensuring they receive a fair return.**
    We have no comment to make at this time.

46. **We are interested to hear from stakeholders on how they believe we should set allowances for the cost of debt, particularly around the method of recalibrating the index.**
    We have no comment to make at this time.

47. **We also welcome views on our proposed approach to setting allowances for the cost of equity, as well as our proposal to move away from RPI.**
    We have no comment to make at this time.

48. **Finally, we would like to hear stakeholders' views on our proposed introduction of a 'sculpted sharing factor' in instances of high out- or under-performance, or whether an alternative mechanism could be more effective.**
    We have no comment to make at this time.