

Dear Akshay,

This email responds to the invitation in your open letter consultation to comment on “any other issues you believe we should address”. It links to questions 28, 20 and 2 in the consultation, but is mainly addressing a topic that seemed to be omitted from the consultation, namely the interaction between democratisation and decarbonisation (and decentralisation and digitalisation).

I am a member of the CEG for WPD, where issues raised in this response have been discussed over the past few months, but this response is on behalf of 4D Economics Ltd and not on behalf of or in any way representing the CEG or anyone else. It is not confidential.

The interaction of democratisation and decarbonisation in energy has been gaining ground for a few years – for example in work that Ofgem was involved with in the West Midlands in 2017-18. But I am encouraged to think there might be a window of opportunity for Ofgem to act because of the following recent statements:

“The process for making long-term strategic investment decisions needs to reflect the changing decision-making landscape, and the varying needs of consumers, across the UK. Devolution to Scotland, Wales and Northern Ireland, and to city regions within England, has implications for the regulatory system....

Robust and transparent engagement mechanisms should also be put in place with metro mayors and local authorities to understand their priorities where they have material interactions with these ... sectors.

For certain issues, the regulators look to government to represent the public. The UK government has typically represented the public to the regulators in these scenarios. But devolution has changed how government works. With increased devolution, the relationship between regulators and government cannot be assumed to be solely with central government, and nor can they assume that the public’s preferences are the same in every part of the country. The regulators should look to engage with consumers’ views, both directly and through utility companies, consumer advocate groups, and elected representatives.

However, while these mechanisms should ensure effective consideration of perspectives from all parts of the UK, this does not mean there is a case for more ambitious policy or investment priorities in one area to be cross subsidised by another area.”

And in particular:

“In future price controls, regulators should demonstrate how they have taken consideration of the strategic vision of metro mayors and relevant local government, within devolved powers, where this has material impacts for network investment”

All these quotes come from the National Infrastructure Commission’s recent report “Strategic Investment and Public Confidence”. If they are combined with the RIIO vision for companies to engage directly with customers and local stakeholders, they open up some exciting possibilities.

It isn’t clear to me whether RIIO-ED2 is a “future” price control in terms of the NIC recommendation, but that is a moot point – Ofgem has a great opportunity now to put the NIC’s recommendation into action in RIIO-ED2. The positive comments in recent days from the Ofgem chair, current CEO and prospective CEO about playing a positive role in decarbonisation clearly indicate that action must be expected from Ofgem and it is very simple for Ofgem to act now, to open the door to the type of change that the NIC and many other stakeholders are calling for, whilst avoiding cross-subsidisation.

All that is required is for Ofgem to indicate to the DNOs that they should engage with local and regional elected bodies, to understand their environmental and other policy priorities, that their ED2 business plans should reflect robust consideration of these priorities and that where delivery of these priorities leads to DNO actions that will have non-trivial short-term costs (in the RIIO-ED2 period), Ofgem would look favourably on charging modifications which enabled these costs to be borne by customers in the same geographic area as the relevant political boundary. This does not require Ofgem to make any pre-commitments to approve anything, nor to assess the practicalities of such charging modifications – if the regulator is no longer a barrier to reflecting local consumer interests as evidenced through the political process, the DNOs and others can take on the responsibility for figuring out how to implement such a model in practice. Hopefully the industry systems and regulation are not so sclerotic as to prevent change to charging happening by 2023, but even if it takes longer then it would still be valuable within the ED2 period. The CEGs that have been or are being established for RIIO-ED2 can help facilitate and provide assurance on the process of establishing local priorities and costs.

I hope you will see that this is a great opportunity to unlock a more creative and dynamic process for RIIO-ED2 and put Ofgem on the right side of the issue – enabling what people want, working with the grain of local democracy and the legitimacy of elected bodies, bringing decisions about

costs, benefits and externalities together, and without requiring Ofgem to introduce any new cross-subsidisation. It is a chance for RII02 to be seen as ground-breaking and a positive change. It allows you to avoid Ofgem being drawn into the weeds of a myriad of local issues and repeatedly portrayed as the blocker. **It also offers the sector as a whole a chance to step up to the challenge of legitimacy.**

I would of course be happy to discuss this further if that would be useful.

Kind regards,
Martin Crouch
Managing Director
4D Economics Ltd