

By email: fwp@ofgem.gov.uk

Your ref

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Date

21/02/2020

Contact / Extension

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Dear FWP team

SP Energy Networks (SPEN) welcomes the opportunity to comment on Ofgem's Forward Work Programme. This is a time of considerable change for the energy industry, as governments in both Scotland and Westminster have committed to Net Zero targets by 2045 and 2050. Given our role as a network operator of both transmission and distribution networks, we are taking this opportunity to share our thoughts with Ofgem on their Forward Work Programme, which we consider will shape the future of our energy system.

From a policy and regulatory perspective, there are many changes being introduced, including an overhaul of the charging framework, proposed new competition models, new Distribution System Operator models, new distribution and transmission price controls, further consolidation of the whole system approach, code revision and the increasing decentralisation of the existing energy system. With the Forward Work Programme focusing on short term issues, over the period 2020-2022, we consider that the Work Programme should include a wider overview of Government and Ofgem's intended system architecture, which will determine the makeup of the energy market in the longer term. Without a clear vision, the Work Programme could appear reactive at a time when Ofgem should be contributing to setting out a clear blueprint for our future energy system; balancing the needs of current and future customers and seeking to determine what an optimally balanced system is, which is affordable and secure for all customers.

We welcome the publication of Ofgem's recent Decarbonisation Action Plan, which sets out Ofgem's proposed actions over the next 18 months on the journey to Net Zero. We support many of the actions that Ofgem have included and note that many have a longer-term view than the 18 months that the plan has been written for. We also fully support Ofgem's addition to the Decarbonisation Action Plan to reflect the Scottish Government's Net Zero targets. It would be helpful for Ofgem to confirm how it intends to consider the policies and priorities with which the Scottish Government aims to achieve these.

As the Government's White paper is due to be released in the Spring, we believe it would be helpful to all stakeholders if Ofgem published a "White Paper update" which explains how the White Paper will translate into any revised Forward Workplan and RIIO-2 as the White paper will likely not be published in advance of the final Forward Work Programme.

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The Forward Work Programme makes reference to expanding the scope for competition across the sectors where competition delivers value for consumers and encourages the penetration of flexible and non-traditional alternatives to network reinforcement. Ofgem acknowledges that competition should only be implemented where this delivers value for consumers. However, we believe this must deliver long term value for consumers. There may be quick savings from some forms of competition initially, however the longer-term costs may be significant and erode any value for consumers. For example, new parties could be incentivised build sub-standard, low quality assets to save upfront costs to gain market entry. The longer-term impact on consumers of additional maintenance, poor reliability, and earlier replacement will bring increased costs and reduce reliability and security of supply. A detailed cost benefit analysis must form part of the networks package in Ofgem's Forward Work Programme in relation to competition, to ensure the optimal long-term solution for consumers.

As more and more customers adopt low carbon heat and transport solutions, the increasing demand impact on the grid must be monitored closely to ensure that future network investment does not lag behind consumer need and hinder market development. Ofgem needs to demonstrate leadership by developing appropriate regulatory mechanisms, enabling network companies to anticipate and encourage progress towards net zero, for example, by supporting flexible charging for transport and ensuring connections are controlled and monitored down to the lowest voltages. It is vital that DNOs have continued sight of what is connecting to each domestic premises to ensure there is no risk of supply failures, or worst case scenario incidents of fire. As the Competition and Markets Authority (CMA) proposes that heat networks should be regulated by Ofgem, we believe this will be of utmost importance to Ofgem as part of its Future Work Programme.

Ofgem's Work Programme provides an opportunity to set out the blueprint for the future energy system, and how Ofgem's regulatory system will deliver this. In the appendix, we offer detailed comments on the actions that Ofgem have laid out in their programme of work where applicable to electricity networks.

Please do not hesitate to contact me if you wish to discuss any of the points raised in this response further.

Yours sincerely



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## **APPENDIX**

Below we set out our comments on Ofgem's actions under each of their strategic objectives:

### **1. Enabling Competition and Innovation**

#### **Network Price Control Design, Development and Implementation**

We support Ofgem's intent to simplify the price control framework in order to be more accessible to users. However, we question whether this will be achievable given the complex mechanisms Ofgem have proposed to include within RII0-2. This is not least evident in the competition models that Ofgem have proposed over the last 18 months that are set to feature in the upcoming RII0-T2 and RII0-ED2 price controls. We note that Ofgem include competition in onshore networks within their Forward Work Programme.

SPEN has, and continues to be, supportive of competition, and continues to embed competition across the day to day business of our organisation. We currently tender a significant proportion of the construction of our onshore transmission and distribution networks on the open market. For example, nearly 96% of our regulated transmission construction activities are delivered by the market. We favour competition in our network where it is properly legislated for, under the "early model", allowing maximum opportunity for innovation of design and planning of schemes through to efficient physical delivery. We believe that, in distribution, this will be achieved through flexibility and the evolution of the DSO model.

Eighteen domestic energy suppliers ceased trading since the end of 2016. As a result, hundreds of thousands of consumers were moved onto tariffs with energy suppliers they never picked. Although some insolvencies are a normal feature of competitive markets, this experience suggests that lowering entry barriers without appropriate checks on the ability of new entrants to deliver has not been in consumers' long term interests. We believe that the same principles should apply to networks companies. Ofgem should learn lessons from the supply industry and not rely exclusively on "pure, classical free market economics" in a natural monopoly context unless there is evidence that it will deliver an economic, co-ordinated and most importantly, safe network for consumers.

#### **Energy System Operations**

We support Ofgem's ambitions for DNOs to meet their evolving customer needs through flexibility. We have already developed and tendered for flexibility services with a view to utilising flexibility for deferring or avoiding the need for network reinforcement and to provide additional network security during planned outages. We have already implemented a process and developed design tools to quickly identify reinforcement projects where flexibility is likely to be a viable alternative. This resulted in an initial tender in March last year, for 116MVA of flexibility services across three network groups. In December 2019, we launched our second round of

Flexibility Tenders seeking up to 95MW of Flexibility Services which we will shortly publish the results for.

Ofgem have stated that they will continue to develop their policy approach to DSO throughout this Work Programme period and will consider its role in delivering Net Zero. To support an increasingly flexible and decentralised energy system, DNOs should be allowed to transition to DSOs quickly to ensure that coordinated, regional plans can be developed in time to address and respond to the challenges, utilising the most appropriate solutions.

We believe there are three fundamental issues that Ofgem must consider when developing their policy approach for the DSO:

- There is currently no clear description of the overarching purpose(s) of the DSO transition. It is essential to have clarity as it will guide the work programme, help resolve where objectives conflict, and help avoid confusing approaches with end goals which benefit customers
- In implementing DSO, the characteristics of the network and the laws of physics must be respected as these are absolute.
- We, as existing distribution licensees, are uniquely placed to implement the delivery of DSO.

## **2. Protecting consumers**

As a network company we are positioned as enablers of the Net Zero transition, however we also believe that this transition should be done in a way that is just and fair, so nobody is left behind. Therefore, we welcome the inclusion in Ofgem's Forward Work Programme of a proposed 'vulnerability principle' for gas and network companies and would seek to understand in more detail what this principle will look like.

We believe that the Treasury's current Net Zero Review may also provide further insights into this matter. Whilst we will implement flexibility ("asset free") solutions as far as the law of physics will allow us to, ultimately network investment will be required. Who pays for this increased investment is a fundamental question for Net Zero. We do not propose a single solution, however, we do wish to highlight that many customers triggering network reinforcements are likely to be customers who have recently connected an EV charging point or Heat Pump. Customers who currently cannot afford to purchase a conventional vehicle, let alone an EV, will unlikely be the customers triggering this reinforcement.

The Scottish Government's Just Transition Commission is due to publish its Interim report in which may provide findings to inform future policy in relation to ensuring that the Net Zero transition is a fair one.

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### **3. Decarbonising to deliver a net zero economy at the lowest cost to consumers**

#### Energy Network Charging Reforms

We support the ambition of both SCRs that are currently in progress so that charges are allocated in a way that is fair, and also to encourage more efficient use of the system.

We would encourage Ofgem to consider offering greater certainty on how the charging SCRs will fit with other major industry changes, for example, RIIO-ED2 and the DSO model. This would require Ofgem to give a longer-term view beyond the scope of this work programme. It is important that any charging outcomes are determined in sufficient time to ensure that DNOs are able to take any resulting network impacts into their RIIO-ED2 business plan submissions.

#### Decarbonisation Heat and Transport

We welcome the publication of Ofgem's Decarbonisation Action Plan. Its timing is imperative given the importance the industry has in achieving Net Zero targets. Being the only DNO who operates in Scotland, England and Wales, we are particularly pleased to see that Ofgem have recognised that many regional ambitions are going further than the UK government targets. Scotland, for example, requires Ofgem to operate a regulatory framework which is supportive of Scottish Government's 2045 Net Zero ambitions.

The need for anticipatory investment has already been supported in two reports by the Infrastructure Commission for Scotland<sup>1</sup> (ICS) and the UK's Electric Vehicle Energy Taskforce<sup>2</sup> (EVET), and so we are pleased that Ofgem have provided direction on this issue and are set to develop additional guidance before ED2 so that we are able to make proposals for such cases.

This summer, we anticipate the Government's long-awaited decarbonisation of heat roadmap. As the RIIO-ED2 sector specific decision is due to be published in November, we believe Ofgem's policy team will be required to provide a focus on heat to ensure that they are able to include detailed recommendations in their decision as to how DNOs should address heat.

As the Government's White paper is due to be released in the Spring, we believe it would be helpful to all stakeholders if Ofgem published a "White Paper update" which explains how the White Paper will translate into any revised Forward Workplan and RIIO-2.

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<sup>1</sup> Infrastructure Commission Scotland Key Findings Report: A Blueprint for Scotland (January 2020)

<sup>2</sup> Report of the Electric Vehicle Energy Taskforce: Energising Our Electric Vehicle Transition (January, 2020)