

# Appendix 1: response to RIIO-2 Draft Determinations Core Document questions

September 2020



# Contents

1 Overview ..... 3

2 Embedding the consumer voice in RIIO-2 ..... 4

3 Quality of service – setting outputs for RIIO-2 ..... 5

4 Ensuring efficient cost of service..... 7

5 Ensuring efficient financing..... 9

6 Managing uncertainty ..... 9

7 Net Zero and innovation ..... 15

8 Approach to the Totex and Business Plan Incentive Mechanisms ..... 22

9 Interlinkages in RIIO-2, post appeals review and pre-action correspondence ..... 23

## 1 Overview

Electricity North West Limited (ENWL) is an electricity Distribution Network Operator (DNO). Our interest stems from the potential consequential impact on the framework development for ED2, commencing in 2023. The price controls for Gas and Electricity Transmission will impact our customers who benefit from these services as well as how those sectors work with us to decentralise and decarbonise the energy network.

We have some concerns that the Draft Determinations refer to common sector-wide measures without qualification that these do not apply to ED. We note that in the Sector Specific Methodology consultation Ofgem states it is “clear that RIIO-ED2 is a separate process, however in the design of our proposals for RIIO-ED2, we have taken into account the lessons learnt and the feedback we have received from the other sectors.”<sup>1</sup> We would welcome more clarity being provided to stakeholders that decisions made as part of this Draft Determination process are not binding for ED2.

We have answered selected questions although we would note that absence of comment in relation to a given area does not imply ENWL is in agreement with any given position or that we deem it suitable for applicability to ED. We strongly believe the RIIO-ED2 framework needs to be considered on a standalone basis where proposed policy positions are established and justified for the ED sector specifically, distinct from GD2 and T2. We will therefore provide more detailed response to relevant areas as part of our ED2 Sector Specific Methodology Consultation (SSMC) response which is due to close in early October of this year.

We note that the Draft Determinations are challenging with tough proposals being taken in all areas. In combination, this could make the price control overly stretching and risk adverse consequences for consumers at this crucial time in the journey to Net Zero and decarbonisation. Careful consideration should be given to this, as there is little or no margin for error for all stakeholders in facilitating and supporting national and regional Net Zero targets. We welcome novel and new policy approaches being raised, however, being included as part of Draft Determinations without earlier signalling leaves only limited time for all stakeholders, including companies, to work through these before Final Determinations. Therefore, we suggest a further observation relevant for ED2 that fuller proposals are developed earlier in the ED2 process and we look forward to contributing to these.

Ofgem acknowledged in its August 2019 Open Letter<sup>2</sup> on the ED2 price control that it is likely (though not certain) that ED will be the most dynamic of the regulated energy sectors, and Ofgem expect ED networks to see the greatest impact arising from the forces of decarbonisation, decentralisation and digitalisation. Setting the development of ED2 against this backdrop, it is important to recognise the differences between the regulated sectors. A different approach and mindset will be required from Ofgem to ensure that the ED framework developed does not result in the risk of electricity distribution networks being a blocker to decarbonisation. This is important in relation to connection of renewable generation and decarbonisation of transport as the uptake of electric vehicles increases significantly during the period as well as steps to decarbonise heat.

We recognise that there will be uncertainty within the ED sector, however this can be managed through well-defined targeted uncertainty mechanisms and volume drivers. This will ensure customers do not pay unnecessarily, reduce the regulatory burden associated with many time

---

<sup>1</sup> RIIO-ED2 Methodology Consultation: Overview, para 2.4, Ofgem

<sup>2</sup>[https://www.ofgem.gov.uk/system/files/docs/2019/08/open\\_letter\\_consultation\\_on\\_the\\_riio-ed2\\_price\\_control.pdf](https://www.ofgem.gov.uk/system/files/docs/2019/08/open_letter_consultation_on_the_riio-ed2_price_control.pdf)

consuming and lengthy re-openers as is described in the Draft Determinations, whilst providing the ability for DNOs to access funding where the need arises.

This response to Ofgem's RIIO-2 Draft Determinations - Core document should be read in conjunction with our covering letter and associated responses within our supporting annexes. We would also urge that our response is considered in light of our previous responses to the RIIO-2 framework consultations.

## 2 Embedding the consumer voice in RIIO-2

*Q1 What role should Groups play during the price control period and what type of output should Groups be asked to deliver? Who should be the recipients of these outputs (companies, Ofgem and/or stakeholders)?*

We believe there is value in the Groups having an ongoing role throughout RIIO-2, especially with respect to encouraging companies to deliver on their customer and stakeholder engagement strategies. However, Ofgem needs to give greater transparency of how it takes the views of these Groups into account and provide clearer and ongoing guidance if there is a particular aim or aims for these Groups to achieve.

It would be preferable to keep the existing model of one Group per company as opposed to a single sector Group. This is because, in our experience Groups have built up a detailed and in-depth understanding of individual companies' strategies and customer bases.

Some form of annual reporting to companies and Ofgem could be beneficial, but this should avoid duplication of existing reporting requirements e.g. business plan commitments reporting as in ED1 for DNOs and the proposed PCD reporting in RIIO-2. Consideration should be given to how the report from the Groups is utilised by the sector including Ofgem and how any additional reporting fits with Ofgem's own reporting too (e.g. the annual reports) to ensure benefit of the activity and efforts by the stakeholders involved.

*Q2 What role should Groups take with respect to scrutinising new investment proposals which are developed through the uncertainty mechanisms?*

We are not convinced that it is in the best interests of consumers and network users to ask Groups to scrutinise new investment proposals developed through uncertainty mechanisms. We would expect that the parameters for such mechanisms will be set out in the relevant Licences and Guidance and that any applications submitted under these mechanisms would be subject to close scrutiny by Ofgem as part of its assessment process. In the case of Net Zero re-openers this would presumably be duplicating the work of the Net Zero Advisory Group as well. Ofgem is likely to need to be much more agile going forward. Adding more layers of input could lengthen timescales for proposals to come to Ofgem, Ofgem's assessment of them might be more complicated for limited benefit so a role for Groups in new investment proposals may not serve consumers interests overall.

If Ofgem does proceed on the basis as proposed within DDs, then it is critical that the scope of any input is clear, and the conclusions drawn by the Groups are reflected in any decision made by Ofgem.

*Q3 What value would there be in asking Groups to publish a customer-centric annual report, reviewing the performance of the company on their business plan commitments?*

Based on our experience with the current framework for RIIO-ED1 we do not see the value in asking Groups to publish an external facing report. DNOs already produce an annual business plan commitments report, which is compiled with stakeholder input and further reporting by Groups would be a duplication of this work with little or no additional benefit to customers.

Within the DD documents there are a number of reporting requirements being proposed, including reporting on Price Control Deliverables (PCDs), outputs, Consumer Value Proposition (CVP), Annual Environment Report (AER) and Digitalisation Action Plan progress amongst others. How this suite of reporting should evolve, for what audience and what consumer benefit should be carefully considered alongside any proposal of a further Group generated report so that companies, stakeholders and Ofgem are clear on the purpose, location, timing and content of reports. It is important to ensure that all reporting obligations provide the necessary consumer benefit and company transparency as a trade off to the time, resource and cost of creating such reports. Rather than producing a separate report, benefit might come from the Groups reviewing the companies own reporting.

*Q4 What value would there be in providing for continuity of Groups (albeit with refresh to membership as necessary) in light of Ofgem commencing preparations for RIIO-3 by 2023?*

As indicated in our answer to Q1, we can see value in the providing for continuity of Groups in light of commencing preparations for RIIO-3. A decision should be taken once Final Determinations are made and based upon the sector by sector benefits the Groups have delivered.

Based on what we have seen in terms of how much Ofgem has intervened in business plans that were strongly supported by user and customer engagement groups (CEGs), further work is needed on the role of Groups looking at the next price control. Given that a significant amount of time and effort has been invested in both Groups and companies in building up a detailed knowledge of the companies and the price control, it would be sensible to ensure that that knowledge is retained by the Groups as companies move through RIIO-2 into RIIO-3, but this is only sensible if Ofgem places weight on these Groups views.

### 3 Quality of service – setting outputs for RIIO-2

*Q5. Will the combination of the two proposed Licence Obligations support the delivery of a digitalised energy system and maximise the value of data to consumers?*

Licence obligations on a Digitalisation Strategy, Action Plan and adoption of best practice are expected to bring benefits in line with Energy Data Task Force findings. More work needs to be done on how energy data is used by stakeholders to say how and to what extent this will flow through to consumer benefits. Where data results in benefits to network businesses themselves and the benefit outweighs the cost, Ofgem can expect companies to get on with digitalisation.

We are aligned to the principles of best practice guidance and the principle of presumed open data, triaging such data and building this into governance structures will be the next steps we take.

We would caution however that some aspects of the guidance will bring significant challenges and costs involved in compliance and this needs to be considered when allowances are set in this area. Uncertainty over the standard approach to be taken means that companies may not be able to fully estimate the work involved in transitioning to a standard specified model.

The subject of data which networks do not routinely collect but may be requested by stakeholders also needs to be considered, with guidance and expectations to be shared so that companies and stakeholders are clear on areas of responsibility.

*Q6. Do you agree with our proposed frequency for publication of updates to the digitalisation strategy and the digitalisation action plan, respectively?*

We agree with the frequency of publication of updates to the digitalisation strategies but feel the publication of digitalisation action plan updates every 6 months is too frequent and will place a significant burden on companies in terms of preparation and approval for external publication and will result in engagement fatigue quite quickly.

*Q7 What kinds of data do you think should comply with the data best practice guidance to maximise benefits to consumers through better use of data?*

We will continue to work internally, and across industry towards the principles set out by the Energy Data Task Force, that data is presumed open, and is 'discoverable, searchable, understandable', with common 'structures, interfaces and standards' and is 'secure and resilient' and where appropriate will feed into the best practice guidance and other industry initiatives as they are developed.

As we continue our work in this area, we will become more informed as to which data should comply with the guidance.

We are a proactive contributor in the industry wide 'Data working group', recently established by the Energy Networks Association (ENA). This group focuses on the digitalisation of the networks across electricity and gas, including provision of network data in line with the recommendations of the Energy data taskforce. We are working with other members to identify new data fields, or value from existing datasets to maximise benefits for consumers. We consulted on our draft digitalisation strategy in December 2019 and are now looking to revise this taking into account stakeholder responses and Ofgem feedback. We have also recently published our Grid Digitalisation & Data Strategy as we continue to seek to better understand stakeholders' views on our steps to maximise the value of data.

We would like Ofgem to publish responses to this question as soon as possible as this data will assist us in understanding stakeholder and customer wants and needs. In addition, Ofgem clearly stating what level of data provision and digitisation network customers should fund is key as there are a range of approaches companies can take with more or less risk for consumers as to the cost/benefit trade off.

*Q8 Do you agree that the Groups could have an enduring role to work with the companies to monitor progress and ensure they deliver the commitments in their engagement strategies?*

Yes, as set out in our response to Q4 we believe there is value in the Groups having an ongoing role throughout the price control though greater transparency of how Ofgem uses the insights from the Groups and what, if any, weight Ofgem places on Groups views needs to be provided to the Groups and other stakeholders. Our CEG is challenging us as we develop our business plan. A key issue is that the extent of the benefit of the Groups continuing is linked to the extent the business plan Ofgem takes forward is recognisable to the independent Group involved in its development. If a completely different plan and approach is taken the case for the Groups reviewing progress weakens. We are awaiting more insight as to what the stakeholder engagement incentive will be in RIIO-ED2 and the role of the Groups should be complementary to this. We do see an ongoing role for them in ensuring that customer and stakeholder engagement remains at the forefront of companies' business operations as we hope Ofgem allows our CEGs insights to shape business plans that are delivered.

*Q9 Do you agree with our proposal to accept the proposals for an ODI-R for BCF and the other proposals set out above as EAP commitments and to require progress on them to be reported as part of the AER?*

We do think that areas of EAP are appropriate for a financial ODI (ODI-F) and note with interest the varied bespoke company proposals presented within company' business plans. The option of a financial ODI should also be considered on its own merits for RIIO-ED2.

Where "we summarise our consultation position on the minimum requirements for the RIIO-2 EAPs across all sectors"<sup>3</sup> this obviously would lend itself to a reputational ODI (ODI-R), however, where companies are able to demonstrate that they have gone beyond these minimum standards "and enhance the natural environment for current and future consumers"<sup>4</sup> there should be a mechanism to incentivise and reward companies to do this beyond a reputational consideration. It would then be for companies, considering the potential enduring role of Groups and through stakeholder and customer research to demonstrate that enhanced outcomes in this area are valued by customers and they are willing to pay for this. This is evidenced by Ofgem where it is stated that "Looking across the companies, we found that the ambition to deliver environmental improvements varied considerably."<sup>5</sup>

The purpose set out in the section of the core document "To ensure transparent and comparable reporting on the environmental performance of gas and transmission networks"<sup>6</sup> is right, although currently there are challenges regarding the scope, consistency and methodology of reporting between companies and also across the sectors. We would support the aim to "provide guidance to the companies on the scope and form of the AER... to hold a working group in autumn to work with the companies to develop the guidance."<sup>7</sup> Ideally, this type of workshop should have been held before draft determinations and it is important that process lessons of this nature can be learned for RIIO-ED2.

We agree with the requirement for the Annual Environment Report (AER) to ensure that companies are transparent in the reporting of the environmental impact of their network as well as demonstrating progress against their EAP, however, we would add that this reporting should be considered in conjunction with other reporting requirements on environmental matters in order to avoid duplication such as environmental reporting in the RIGS.

## 4 Ensuring efficient cost of service

We note the positions set out in this section of the DDs and that the process and assessment of efficient cost of service is bespoke to each sector. Given the unique characteristics of ED it is important that all parameters, methods and elements of ensuring efficient costs are developed appropriately for that sector. Where proposals made as part of this DD are considered appropriate to apply to ED then Ofgem should clearly state why this is appropriate and this should be consulted on as part of the ED2 SSMC.

As such, to the questions contained in this section of the document we would like to offer some macro comments but note these are principle points rather than a comment on the process that should apply to GD/T2. We also note that Real Price Effects (RPEs) allowances and ongoing efficiency assumptions

---

<sup>3</sup> Core document, paragraph 4.48, Ofgem

<sup>4</sup> Core document, table below paragraph 4.48, Ofgem

<sup>5</sup> Core document, paragraph 4.52 Ofgem

<sup>6</sup> Core document, table below paragraph 4.48, Ofgem

<sup>7</sup> Core document, paragraph 4.63, Ofgem

form part of the referrals of the final determinations in PR19 to the CMA and as such it is important that robust and well evidenced conclusions and allowances are made with respect to these two items.

*Q10 Do you agree with our proposed RPEs allowances? Please specifically consider our proposed cost structures, assessment of materiality, and choice of indices in your answer.*

We welcome that the approach to cost assessment and application to ED is being consulted on as part of the SSMC.

We agree with the question that the *proposed cost structures, assessment of materiality, and choice of indices* are crucial to ensuring a fair assessment and allowance for RPEs. As with the process run for GD/T2 this assessment and proposal needs to be done on a sector specific basis as can be evidenced by the use of notional company cost structures for GDNs and company specific cost structures for transmission companies.

Ofgem should consider very carefully the impact of COVID-19 and the impact this will have on the indexation used in the ongoing annual true-up of RPE and allowances. Consideration should be given to whether the index used will reflect the legitimate cost pressures faced by the sector if it is couched in the experience of the wider economy. Ofgem indicates its view that the impact of COVID-19 on the energy sector is different to the wider or more general economy, and this should be considered very carefully with respect to RPE allowances and ongoing true-up mechanisms.

*Q11 Do you agree with our proposed ongoing efficiency challenge and its scope?*

We note that the proposals on ongoing efficiency are at the top end of the plausible scale as assessed by CEPA. We also note that this aiming up is partly justified by the impact of innovation funding, structure and characteristics of the monopoly industry we operate in. Where the benefit of part of the existing framework is cited as evidence to support stronger measures as part of RIIO-2 this should be noted and collated to a central table to ensure evidence that these benefits are not being double counted.

Innovation investment has been primarily focused on meeting future challenges and supporting customers. The resulting efficiencies are visible in company submissions to the regulator. Innovation funding hasn't been focussed on reducing the costs of ongoing operations and existing requirements which companies are incentivised to do through other levers in the RIIO framework such as the TIM. Careful consideration of the calibration of ongoing efficiency and what this is aimed at achieving, as well as the consideration of catch-up efficiency and what that covers, needs to be given when justifying regulatory positions. It's important that being innovative doesn't become a zero-sum game to companies who need to balance a range of priorities. The regulatory framework needs to have real rewards for innovation, not unmerited additional discounts to future costs for past success in addressing future long-term challenges facing consumers, stakeholders and companies.

We have concerns that Ofgem are confusing and mis-applying the various levers in the RIIO toolkit and what they are designed to cover based on the justification for the proposed positions in Draft Determinations (e.g. ongoing efficiency and catch-up efficiency).

We also have concerns that the impact of COVID-19 is being underplayed and underassessed in these DDs. A global event with the impact that COVID-19 has had is unprecedented. Particularly given the timing of Gas and Electricity business plan submissions in December 2019 meaning that these plans won't have been able to reflect COVID-19 impacts.



In operating our ED business, at the time of this response in September 2020, we are still assessing the medium and longer-term implications of COVID-19. Any ongoing productivity assumption needs to be cognisant of this unknown impact and be calibrated in a way that isn't bullish in its assumption without quantification of all the facts.

## 5 Ensuring efficient financing

Please refer to annex 1 which provides our detailed comments on the financial issues raised within DDs.

## 6 Managing uncertainty

In general, to effectively manage uncertainty within the RIIO-2 framework, ENWL support a limited number of targeted uncertainty mechanisms that are well defined and are clear to what risk or uncertainty they address in the period. We do not support macro or broad measures such as the mid-period review reopener deployed in ED1, as the broadness of the mechanism leads to a lack of clarity for companies and Ofgem about how, why and when these should be applied and assessed. With ED2 starting two years after that of GD/T2 we believe that the level of uncertainty required to be managed should be less and therefore the approach taken for GD/T2 should not directly apply to ED2 for the reasons explained in our Overview section.

Indeed, we have concerns where the Draft Determination refers to "Cross-sector uncertainty mechanisms" without qualification that these should or shouldn't apply to ED. We are pleased to see uncertainty mechanisms and wider methods for managing uncertainty for ED are being consulted on separately and independently of the DDs through the ED2 SSMC. We note this should consider the impact on the level of uncertainty but not be limited to; the later start date for ED2, the differences of the challenges in ED compared to GD/T, and the lessons learned from the responses to the proposed package for managing uncertainty from this DD consultation.

*Q12 Do you agree with our proposed common approach for re-openers?*

As discussed above any mechanisms for managing uncertainty, including re-openers, should be clearly defined and targeted.

The most critical process consideration for re-openers is that Ofgem will need to be able to make material decisions much more rapidly than today's processes and based, relatively speaking, on incomplete information in a faster changing world compared to Ofgem's normal requirements for certainty including complete evidence of the highest standard. Greater transparency from Ofgem, laying out the basis on which it intends to take decisions will enable companies to react quickly to emerging needs and challenges as set out in the framework re-openers. The ability for Ofgem to act quickly is crucial to ensure Ofgem itself doesn't inadvertently become a blocker to decarbonisation and decentralisation of the energy system.

A common approach has a benefit of being clear and easy to understand where this is to apply in most of cases. We have concerns with the proposed approach for each of the parameters set out in the DD as shown in the extract table and related comments below.

| Re-opener parameters          | Consultation position   |
|-------------------------------|---|
| Re-opener application windows | Bring forward re-opener application windows from May to January.<br>Reduce re-opener application window from one month to one week (ie last week of January).   |
| Application requirements      | Provide additional detail and guidance where possible in licence conditions and guidance.   |
| Authority triggered re-opener | Authority can trigger a re-opener at any time during price control.   |
| Materiality threshold         | For each individual re-opener application, set a materiality threshold such that we will only adjust allowances if the changes to allowances resulting from our assessment, multiplied by the TIM incentive rate applicable to that licensee, exceeds a threshold of 1% of annual average base revenues (as set out in Final Determinations).<br>Allow for aggregation of some re-openers subject to specific criteria. |

Taking each of the elements in turn:

- Re-opener application window:** The greater reliance on UMs and re-openers as proposed in the DDs will result in increased regulatory burden and this should be considered when making any changes to application windows or timescales. By bringing forward the application window from May to January, it is clear the only benefit is a longer assessment time for Ofgem, however, this isn't consistent with the need for agile and timely decision making as the speed of decarbonisation and the pathway to Net Zero becomes clearer. Consumers and the industry need a quicker and more appropriate approach to re-opener decisions given the large number of decisions Ofgem has positioned itself to need to make. It is unlikely to be sustainable without an overhaul to decision making processes that could impact many stakeholder's roles.

- **Application requirements:** We support the clarification and proposal to provide additional guidance to companies and all stakeholders. We also agree with the proposal to consult on the guidance and any subsequent amendments, before it comes into effect, but this must be done before price control starts and ideally should be done before Final Determinations. We would urge that this guidance and requirements on companies are proportionate and cognisant of the impact on the regulatory burden placed on companies and Ofgem. Its aim should be to support key objectives and not slow down the process and thus the regulatory requirements become a barrier to the industry in delivering essential activities under decarbonisation, Net Zero, or other considerations. Guidance should be clear and set out the requirements to ensure companies are aware of the criteria to which the authority “may reject any re-opener application that does not contain all the information necessary for us to make an informed decision on the contents of the application”<sup>8</sup> as set out in 7.21. As much as possible the company and stakeholders need to understand the basis and approach of Ofgem’s decision making so that the presented proposal from the companies align with Ofgem’s expectations and views.
- **Authority triggered re-openers:** We think that this parameter should apply to a small number of re-openers with defined windows, where consumer benefit can be demonstrated and not be applicable to any or all re-openers by default. We have concerns that this will increase uncertainty on companies.

The process for triggering re-openers should be the same for both Ofgem and companies in terms of certainty and clarity as to what might be triggered when. This isn’t the case as it stands in proposals where the Ofgem can trigger at any point. Certainty and clarity underpins good regulatory practise and an open-ended asymmetrical process does not provide this to companies and stakeholders alike.

- **Materiality threshold:** We support the flexibility to aggregate re-openers where there are items that don’t meet materiality on their own. It is unclear on reading the DD documentation precisely which re-openers are and are not eligible for aggregation and transparency is key. We would urge that a clear table is produced showing each re-opener and the associated parameters. It is also not clear why a higher or even a different materiality threshold should apply to aggregated items<sup>9</sup>. By the Ofgem definition a materiality threshold “provides a balance to ensure network companies and consumers are protected from significant variations in expenditure over the price control”<sup>10</sup> where significant variations should be based on the same definition, i.e. no difference between a single item materiality threshold and an aggregated claim where appropriately evidenced and justified against the relevant criteria. Also applying the company specific sharing factor (TIM) has the same effect of changing the level of significance between companies as well as the effect of a lower TIM than in RIIO-1 having the result of increasing materiality from RIIO-1 levels, which is inconsistent with a lower risk price control. Under a lower risk, lower returns price control it would be a surprise if materiality thresholds increased. A flat percentage of allowances, reviewed in the round to ensure risks are not increasing for companies with lower returns, would be simpler and not create differences in what is or is not significant between companies.

---

<sup>8</sup> Core document, paragraph 7.21, Ofgem

<sup>9</sup>Core document, paragraph 7.34, Draft determinations give the example of 3% compared to 1% for single item re-openers.

<sup>10</sup> Core document, paragraph 7.32, Ofgem

*Q13 Do you agree with our proposals on a materiality threshold, a financial incentive, a 'foreseeable' criterion, and who should trigger and make the application?*

We believe that it is essential that whole systems outcomes are, as a minimum, not precluded by regulatory arrangements and, where appropriate, should be enabled and incentivised to ensure that all network companies are focussed on delivering the most optimal outcome for all relevant consumers.

From discussions with Ofgem, we are anticipating that the Co-ordinated Adjustment Mechanism (CAM) is designed as a back-stop solution to be used in rare circumstances (especially in a shorter price control period) rather than one expected to be used commonly as fully formed plans should be developed by companies including consideration between all stakeholders as to which outputs and allowances should be set.

The approach Ofgem has taken in GD/T Draft Determinations by excluding any uncertain investment, instead preferring the use of uncertainty mechanisms means that the CAM is even less likely to be used as only those certain costs and projects are allowed in baseline expenditure. This results in the likelihood of another network being able to offer a whole system solution to the overall benefit of customers being even lower. **In light of this, and the potential complexity of the CAM and its timings, we believe it is worth Ofgem considering whether there is sufficient justification for the inclusion of this mechanism within RIIO-2.** If Ofgem does decide that the mechanism is required, we believe it should be developed bilaterally with companies. This is contingent upon Ofgem retaining the view that CAM is a mutual company consented mechanism where this is triggered by a single company.

Consideration needs to be given to projects identified within company plans, or that emerge within period where a whole system solution is identified, but due to the wider use of UMs no licensee has the ex-ante allowances/output obligation to be able to transfer it. The company triggering the UM to receive the funding adjustment to then transfer to another licensee appears impractical, and therefore there is a need for some method of the company delivering the solution to be able to have their revenues and outputs adjusted to take into account the new obligation. As it is currently designed the CAM is not able to do this with its prime purpose transferring from one licensed entity to another. The Net Zero re-opener could be one potential solution but would need to be adjusted to allow companies as well as Ofgem to be able to trigger this re-opener.

We make further comment on the CAM below:

- We consider the CAM only being applicable to asset-based solution as, flexibility-based solutions, or other such services will be managed on potentially shorter-term timescales through commercial arrangements.
- We agree with there being no materiality threshold, instead with a focus on ensuring customer benefit and we also agree with the logic that companies would not progress with an application where benefits are speculative or hard to demonstrate.
- Whilst we acknowledge that there will be a licence obligation (LO) on whole system co-operation and collaboration within RIIO-2, incentivisation within this area will further support the drive of focus towards whole system solutions and ensure that companies see the broader benefit of a CAM application. We support the intent of companies agreeing compensatory value associated to risk of any transfer and a share of any intended benefits are agreed within the commercial terms between companies when undertaking the CAM proposal and would strongly urge that guidance associated with the CAM is shared ahead of the price control

commencing so that there is clarity over expectations and what sort of levels of commercial benefit Ofgem sees as appropriate. We also believe that greater clarity is still required on what Ofgem will consider customer benefits and treatment of a proposal where material benefit falls outside of the sector enabling the solution.

- We agree there is no requirement for the “foreseeable” criteria.
- We agree with the proposal of application from one licensee, with a statement of agreement with the other licensee. We also agree that this should be network triggered only as a collaboration and not required or initiated by Ofgem on one or both licensee.

We have previously stated that one of the key enablers for whole system decision making is the existence of a whole system cost benefit analysis (CBA) and so are pleased to see this being covered within the Open Networks work, as well as sector specific CBA work. It is important that Ofgem are involved in this work and consider its use within CAM assessment as companies need to have clarity and clear guidance as to what the criteria they must consider when making their operational and investment decisions. Without this clarity in place and a supportive whole system CBA there is no ability to quantifiably conclude that the solution selected is the most efficient given whole system consideration.

We would add that companies have previously raised the subject of costs associated with exploring whole system solutions, preliminary studies and other preparatory work that would need to be undertaken on a routine basis ahead of any CAM application being considered necessary. We understand that the costs for any applications which go ahead would be included in the CAM, but there are also likely to be a range of costs associated with exploration of options that do not go ahead and therefore sit as aborted costs. These will be incurred by all companies as they seek to embed whole system exploration in their BAU approach however these are not costs that would have routinely been incurred in RIIO-1 and need to be considered within company’s overall totex allowances. Guidance over expectations on whole system collaboration and where costs are borne by for example DNOs to support TO exploration or vice versa is required to ensure fair and equitable arrangements are put in place.

We believe the next step in development and assessment of the CAM will be for Ofgem to stress test the CAM under a range of scenarios/case studies to see whether the issues raised in our response can be appropriately managed.

*Q14 Do you consider that two application windows, or annual application windows, are more appropriate, and should these be in January or May?*

Careful thought needs to be given to this question given the timing difference of the RIIO-2 period with the other sectors. The DD currently considers years 2 and 4 as potential windows. This would mean submissions in May 2022 and May 2024 (or possibly January in line with Ofgem’s proposed common position on re-openers).

We would suggest that only one window is practical, and this should apply in year 3 (2023). The usefulness of the second window as being proposed in year 4 will not allow sufficient time for any solution to be delivered within the regulatory period and will overlap with the price control development for RIIO-3.

Consideration of the windows in ED2 is critical to ensure the CAM can be workable as envisaged, we set this out in more detail in our response to the SSMC for ED2 which is due for submission in October.

---

*Q15 Do you consider that the RIIO-1 electricity distribution licences should be amended to include the CAM, or wait until in 2023 at the start of their next price control?*

We were disappointed to see this proposal, not only in the context of RIIO-ED2, but as proposal for in-period licence changes to a sector's regulatory requirements not covered at all by this consultation. We consider this an error in process.

As such we do not expect that any decision will be made on the RIIO-ED1 regime through this consultation and decision. We will respond in more detail through an appropriate Ofgem consultation on RIIO-ED1 arrangements we expect Ofgem to conduct.

Therefore, we do not support proposals made through this consultation to make changes to ED1.

*Q16 Do you agree with our proposed re-opener windows for cyber resilience OT and IT, and our proposal to require all licensees to provide an updated Cyber Resilience OT and IT Plan at the beginning of RIIO-2?*

We agree with the two re-opener opportunities but question whether the first re-opener should be mandatory if the landscape since submission has remained stable.

We recognise that the scope of cyber resilience is uncertain in terms of the threats we may face and the fact that they can change rapidly based on external influences such as geopolitical scenarios, economic scenarios and the deployment of new technology.

OT cyber resilience is inherently bound to Cyber Assessment Framework (CAF) outcomes. As and when Ofgem publish an enhanced profile, company plans may have to be adjusted accordingly.

*Q17 What are your views on including the delivery of outputs such as: CAF outcome improvement; risk reduction; and cyber maturity improvement, along with projects-specific outputs?*

We understand that cyber security and resilience improvements would result in reduced risk and increased maturity and would therefore be demonstrated as a matter of course in any benefits analysis of project outcomes.

*Q18 Do you agree with our proposal for the Non-operational IT and Telecoms capex re-opener?*

As set out previously to effectively manage uncertainty within the RIIO-2 framework, ENWL support a limited number of targeted uncertainty mechanisms that are well defined and are clear to what risk or uncertainty they are to address in the period. We do not support macro or broad measures such as the mid-period review re-opener deployed in ED1 as the broadness of the mechanism leads to a lack of clarity for companies and Ofgem about how, why and when these should be applied and assessed. As such, customers are best served by appropriate ex-ante allowances to companies.

That said a re-opener for non-operational IT and Telecoms capex where a defined external driver can be established is worth consideration on a sector by sector basis.

*Q19 Do you agree with our approach to using a re-opener mechanism for changes to government physical security policy?*

We support the retention of a re-opener to cover Critical National Infrastructure (CNI) to adjust revenues following government mandated changes to network site security requirements. This is exactly what re-openers and uncertainty mechanisms should be used for to cover changes in requirements that are externally driven and outside of companies control with respect to the

requirement to comply with mandated changes. To that end we disagree that a materiality threshold should apply to this re-opener and believe the approach on materiality should be consistent with the Cyber and IT re-openers. Applying any materiality threshold to a mandated and or legislative requirement wholly outside of companies control places all risk on companies which is inconsistent with a lower risk aspiration as set out by Ofgem for RIIO-2.

*Q20 Do you agree with our approach regarding legislation, policy and standards?*

We note Ofgem's position that at DDs Ofgem do not currently propose to include any additional re-opener mechanisms relating to changes in legislation, policy, or technical standards. This is on the basis that Ofgem view they have insufficient information to justify the need for or scope of any such mechanisms in any sector currently.

Specific uncertainties relating to the ED sector will be covered within the RIIO-2 ED2 Sector Specific Methodology Consultation, however we would add that some of the issues raised within 7.88 are also relatable to the ED sector.

We don't think for our ED sector that additional reopeners for legislation, policy or technical standards are required, based on what we are currently aware of, especially with shorter price controls. However, of general applicability in principle to these Gas Distribution and Transmission controls, Ofgem cannot assume that no changes will occur in legislation, policy, or technical standards during the price control period and Ofgem should acknowledge that companies manage these pressures for consumers, by Ofgem ensuring they provide funding and reward for doing so. Also, particularly, where Ofgem is driving or influencing the legislation (e.g. Clean Energy Package), policy (e.g. Connection charging) or technical standards (e.g. cyber standards) then it is vital Ofgem has in mind when making any changes, especially as to their timing, the impact on the price controls Ofgem also set.

In general, Ofgem can assist all stakeholders and reduce costs for consumers by ensuring Ofgem driven or influenced changes are well signalled and timed to inform any changes to customer needs and the setting of price controls at the start of a period or fit into the programmes of UM's put in place. Once a price control has been set, managing the changes and risks during the price control is a source of value for customers driven by companies which needs to be appropriately rewarded and funded as part of the regulatory package in the round.

## 7 Net Zero and innovation

*Q21 Do you agree with our overall approach to meeting Net Zero at lowest cost to consumers? Specifically, do you agree with our approach to fund known and justified Net Zero investment needs in the baseline, and to use uncertainty mechanisms to provide funding in-period for Net Zero investment when the need becomes clearer?*

As these DDs are for the early RIIO-2 sectors, and ED is subject to a separate process we will comment in further detail within our response to the RIIO-ED2 SSMC. We would add that with DNOs due to submit business plans to the Ofgem challenge group in May 2021, covering the period 2023-2028, it is essential that, when assessing plans, Ofgem considers the future decarbonisation requirements and ambitions of both the UK and regions, such as Greater Manchester, that are targeting carbon neutrality at earlier deadlines than 2050. We expect Ofgem to be much clearer on what it expects to see in baselines and what will be rewarded or penalised under the BPI and how it will be assessed.

It is essential that the right environment is created to encourage continued investment for the future. Network investment is essential to realising clean growth and a green recovery by enabling the mass adoption of low carbon technologies such as electric vehicles and solar and providing a

reliable network for all. When Ofgem seeks to ensure Net Zero at lowest cost to consumers, it's important Ofgem outlines how this is assessed as low-cost solutions may be available in the short term but could result in higher overall costs to consumers to meet Net Zero

In principle Ofgem's approach is an option, but it does seem in its implementation to be a significant departure from how regulation has historically worked with much more decision-making reverting back to Ofgem even within the context of shorter price controls where we'd expect to have more predictability.

A major lesson in these price controls is that Ofgem might seek to be more transparent in the criteria it intends to apply to what is known and justified and how Ofgem defines known and justified. Ofgem is likely to face a major challenge in administering the Net Zero transition as the scale of requests for funding could be large (Ofgem has quoted double digit billions) and the need for speedy decisions moving at a pace inconsistent with normal regulatory decision-making practises with only partial information available.

We are surprised that a better balance to include more of the Net Zero proposals into baselines couldn't be reached through these price controls as Net Zero commitments are now enshrined in law, so the strength of need is likely increased leaving timing the more material consideration. We have not seen outlined how Ofgem balances between current and future consumers, as we'd expect many of the Net Zero investments needed to be of real benefit especially to future customers, particularly and possibly more efficiently delivered now rather than through multiple interventions over multiple price controls.

A better solution for customers and all stakeholders would be improved use of volume drivers and a convergence if possible on the level of certainty and criteria for progressing consumer funded investment in Net Zero between all stakeholders. This would mean that the Ofgem led removal of much of the Net Zero supporting investment wouldn't have been a major surprise and there would be better understanding as to how this decision by Ofgem benefitted consumers by not supporting so much decarbonisation driven action now through baseline funding.

It is therefore crucial that Ofgem create a framework and price control determination with the flexibility required to support Net Zero innovation and help companies meet increased consumer demand for low carbon energy sources.

It is appropriate to ensure that baseline funding is granted for known and justified investment needs, whilst investments with high degrees of uncertainty are subject to well defined uncertainty mechanisms (UM). It is important for Ofgem and companies to both be clear on the degree of uncertainty and what constitutes the need for funding to be considered as best served through an UM rather than baseline funding. Given the reaction to DDs we perceive that Ofgem has set the criteria on what goes in a baseline at a different place to that other stakeholders were expecting.

UMs in the form of re-openers, come with a natural degree of regulatory burden, take time and resource for both companies and Ofgem and therefore should only be used when they are considered to be in consumers best interest. Where UMs are to be used to facilitate network investment when a need becomes clearer, there should be an accelerated and transparent process to enable agile decision making and avoid Ofgem becoming a blocker on the country's pathway to decarbonisation. Volume drivers are an attractive option where the unit rate can be set, and the funding adjusts with the volume of an output or outcome as it is required. We provide more detailed comments on UM process within our response to question 12.



*Q22 Do you think the package of cross sector and sector-specific UMs provides the appropriate balance to ensure there is sufficient flexibility and coverage to facilitate the potential need for additional Net Zero funding during RIIO-2?*

See response to question 21 above, however we have some concerns that the DDs refer to common sector-wide measures without qualification that these do not apply to ED (though they may be capable of being considered in due course) and that the decisions on the ED2 price control are not being made now, we would welcome more clarity being provided by Ofgem on this matter.

*Q23 Do you have any views on our proposed approach to a Net Zero re-opener?*

Our view is consistent with our response to the Net Zero Open Letter in May 2020, extracts of which are shared below. We would add that in the interest of transparency, it would be helpful if Ofgem published the Open Letter and the responses received (subject to respondent agreement) so that stakeholders can see respondent views and how this input has shaped Ofgem's thinking. We support transparency ourselves and have published our response on our website<sup>11</sup>.

We note the many references to the Net Zero Advisory Board both with reference to the Net Zero re-opener and also the Strategic Innovation Fund (SIF). It would be helpful for Ofgem to provide more information on the composition and work schedule for this group as there is limited information available at present and therefore it is unclear as to how this will be used to inform any decision by Ofgem to trigger the Net Zero re-opener.

We also recognise that Electricity Distribution has the benefit of time (i.e. Final Determinations in 2022) where policy and pathways may be clearer compared to Gas Distribution or Transmission which are to be settled much earlier. We therefore consider that this reopener proposal is possibly more needed and with greater likelihood of being triggered for the earlier RIIO-2 price controls than for ED2.

#### Scope

ENWL support a limited number of targeted uncertainty mechanisms that are well defined and are clear to what risk or uncertainty they are to address in the period. We do not believe the proposed broad scope of the Net Zero re-opener meets our criteria and therefore our position is that it should be reconsidered.

Our response to the Net Zero open letter proposed that the scope be linked only to those elements driven by change in government policy (either central or devolved), unforeseen breakthroughs in technology driving changes in consumer requirements or significant market driven changes leading to unforeseen lower LCT costs.

The broadness of the mechanism risks leading to a lack of clarity for all stakeholders including companies and Ofgem about how and why these should be applied and assessed. In our response in May we cautioned against setting any Net Zero mechanism with insufficiently defined parameters; these should be tightly set, targeted and linked only to those driven by change in government policy (either central or devolved), unforeseen breakthroughs in technology driving changes in consumer requirements or significant market driven changes leading to unforeseen lower low carbon technology costs.

The wording in the consultation position of "changes connected to the achievement of the Net Zero carbon target not otherwise captured by any other RIIO-2 mechanism"<sup>12</sup>, combined with the proposal

---

<sup>11</sup> <https://www.enwl.co.uk/about-us/regulatory-information/riio2/>

<sup>12</sup> Core document, table below paragraph 8.20, Ofgem

that the re-opener can be used by Ofgem at any time in the price control brings a significant degree of uncertainty and risk to companies that changes to outputs and allowances can be made at any point in time for a variety of unknown reasons.

We are also unclear why there is a need for both the Net Zero re-opener and the Heat Policy re-opener for GD as the Net Zero re-opener appears to have the same trigger as Heat Policy would and this may be an opportunity to remove one UM option.

### Process

Whilst it was pleasing to see the recognition of licensees as providing valuable input to ensure the mechanism can work effectively, it is still unclear within the consultation document what timescales are anticipated for the duration of the process described.

As with the other re-openers or UMs within the DD proposals, the most critical process consideration for the Net Zero re-opener is that Ofgem will need to be able to make material decisions much more rapidly than today's processes and based, relatively speaking on incomplete information compared to Ofgem's normal requirements for a complete and high standard of evidence. This will enable companies to react quickly to an emerging Net Zero need.

Ofgem is clear that it considers a lower returns and lower risk price control to be the aim for RIIO-2, hence any Net Zero re-opener will be reserved for actions that a company will not be able to commit to absent regulatory agreement, as to do so would be higher risk. During RIIO-2 it looks likely that companies will have less financial flexibility to respond quickly to emergent needs and ahead of Ofgem providing funding, therefore cashflow considerations will be more important in RIIO-2 and could result in shovel ready projects needing to wait for revenue to start actually being collected, which in distribution could mean a two year pause until revenues can be set to fund the cash costs of investments. Then supply chains would need to be activated and then commence delivery, likely taking further time. It is therefore critical that any Net Zero re-opener process can be decided quickly and that there is timely positive impact on the cash position of the company if further expenditure is required.

The target should be for Ofgem to make any decision and enable the company to appropriately adjust its revenues to meet any new cash expenditure needs within three months of the start of the process. These kinds of timescales might be what's needed to avoid regulation becoming a blocker to meeting customer needs. Ofgem may want to also consider whether an approach where some initial funding could be rapidly released on a no-regrets/no-hindsight risk basis to allow companies to mobilise to meet urgent customer and stakeholder needs where these arise with a short lead time if Ofgem needs more time to make any decision(s).

### Materiality

In setting the materiality threshold and how the re-opener might work, the RIIO-2 package in the round needs to be reviewed and Ofgem's common approach to materiality should not necessarily be adopted by default. In a lower return price control with potential for more reliance on UMs or specific PCDs there is naturally much less flexibility for companies to respond as they have in RIIO-1 to changing environments without rapid decision making by Ofgem to determine allowances and direct that companies can immediately update their tariffs to fund the obligations agreed.

### Interlinkages

How any Return Adjustment Mechanisms (RAMs) are implemented is also key. Any re-opener funding for Net Zero would need to be adjusted for how any RAM works. This broad point of re-openers and the function of RAMs is a general one, but since a Net Zero reopener might be highly material, the concerns we have about how the mechanism works if RAMs are in place is important.

We strongly suggest that a detailed assessment of the interlinkages between different re-openers in place be carried out and shared and consulted on with companies and stakeholders.

*Q24 Do you agree with our proposals for the RIIO-2 Strategic Innovation Fund?*

We broadly welcome the introduction of the Strategic Innovation Fund (SIF) as it appears to widen the innovation focus beyond the electricity networks, including other energy vectors such as heat. This would appear to have the potential to allow for the qualification for funding of projects not currently allowable under NIC, such as those beyond the electricity meter, which are of net benefit to consumers.

It is important however to obtain a suitable balance between complexity and deliverability, and to avoid the SIF becoming overly expansive and as a result increasingly hard to prepare and, ultimately, deliver projects.

We would also be particularly keen to ensure that projects such as CLASS and Smart Street, which are considered highly innovative in nature, remain viable for funding through SIF as these have significantly positive consumer benefit cases. Both these projects include highly technical, network centric deliverables, not necessitating or requiring the element of co-ordination and collaboration perhaps envisaged within the SIF, but that, owing to their being beyond the scope of NIA, wouldn't have been possible to progress without NIC. In introducing SIF as a replacement to NIC, Ofgem should seek to ensure that projects such as CLASS and Smart Street don't inadvertently fall between the gap in innovation funding (i.e. between NIA and SIF).

*Q25 Do you have any comments on the additional issues that we seek to consider over the coming year ahead of introducing the Strategic Innovation Fund?*

We look forward to learning more about SIF and having further opportunity to comment on its practical application in due course, especially for RIIO-ED2. We note the SIF is ambitious, and there will be lots of work needed to ensure the processes are well understood, practical and ultimately fit for purpose. Similarly, it is our view that ongoing support and regular review will be required to ensure SIF delivers its aims throughout the period of RIIO-2. Ofgem need to be cognisant that this might attract a considerable overhead dependant on the requirements.

*Q26 Do you agree with our approach to benchmarking RIIO-2 NIA requests against RIIO-1 NIA funding?*

We agree in principle with this approach though it needs to be looked at on a sector specific basis. The benchmarking method used ought to suitably consider the changes in innovation challenge in the period between RIIO-1 and RIIO-2 and, if necessary, as evidenced by a network operator through its business plan, make appropriate adjustments. As such, it's important that the benchmarking process is suitably flexible to allow the network operator to present evidence to support a more ambitious innovation proposal for RIIO-2.

*Q27 Do you agree with our proposal that all companies' NIA funding should be conditional on the introduction of an improved reporting framework?*

We agree there are opportunities for improved reporting of innovation-funded activities. We are working with gas and electricity colleagues through the ENA on a range of improvements for RIIO-2 and look forward to continuing discussions with Ofgem on their applicability.

---

*Q28 What are your thoughts on our proposals to strengthen the RIIO-2 NIA framework?*

We believe the proposals to strengthen the RIIO-2 NIA framework are sensible and the direction of travel for NIA is consistent with the broader aims of stakeholders. To appropriately satisfy these aims, the drafting of all associated changes to the NIA governance document will be crucial, ensuring that the strengthening is effective and as intended. We believe the ENA and its member companies can add considerable value to this process, and we are pleased to note the intention of Ofgem to hold workshops on drafting updates to the governance.

We are comfortable with proposals that eligible projects should focus on issues associated with the energy system transition (EST) or they seek to address a particular consumer vulnerability. We consider this narrowing of the focus from that of ED1 to offer potential for better alignment across networks, thereby increasing the opportunity for collaboration between companies. However, as with any change to the eligibility criteria, there is a danger that a project such as transformer oil regeneration, which sought to introduce a viable method of extending the safe operating lifespan of transformers and which is now BAU, would not meet the proposed qualifying criteria for NIA, nor, owing to its being a high-risk, long-term project, would it meet the expected threshold for BAU innovation. Given this, we believe that careful consideration of the appropriate definition of EST and, for similar reasons, customer vulnerability, should be given to avoid potential for innovations such as oil regeneration being considered ineligible for funding thus risking not being done at all. Clearly, such an outcome would not be in the best interests of vulnerable customers and customers more generally who might otherwise have benefited from the increased efficiencies.

We are broadly supportive of the proposal to require all NIA projects to develop solutions that deliver net benefits to customers in the relevant sector as it is these customers that pay for the projects in the first place.

We are pleased to see inclusion for consideration of the impact of innovation upon vulnerable consumers. This is an important development and one we aim to address in part through our Smart Street project, which through its reductions in energy consumed, is expected to deliver significant savings to over 20k vulnerable consumers during ED1 continuing into ED2.

We fully support the aim to increase third-party involvement in NIA. It's crucially important that all network operators continue to engage fully and effectively with third-parties as appropriate on network innovation.

On proposals for the development of a collective guidance document for third-parties covering IP, we are not convinced that this will address the issues of inconsistency between DNOs as is its stated aim. Matters of consistency in application of the governance document are perhaps best addressed through the collaborative working between organisations, most probably via the ENA, to agree, for example, a set of common legal terms covering IP, which can be understood and adopted across all parties seeking to draw upon NIA. Perhaps this work ought to form part of planned future work on redrafting of the NIA governance document.

*Q29 Do you have any additional suggestions for quality assurance measures that could be introduced to ensure the robustness of RIIO-2 NIA projects?*

Whilst needing to avoid costly post-project completion reviews which would appear to offer only limited value, particularly given the high volume of NIA projects, we broadly welcome the addition of quality assurance measures in respect of the robustness of NIA projects in RIIO-2. To add most value this ought to happen at the start of the process during project registration and continue through its delivery.

We consider quality assurance is most effectively and efficiently achieved through self-auditing of projects including for this within all aspects of NIA project reporting (i.e. project registration as well as annual and final reports). Further, we believe the ENA can play a key role in this, perhaps through its facilitating an 'annual audit report' of the portfolio (or a section of based on theme) of NIA projects.

Furthermore, individual network operators ought to consider establishing 'innovation links' with a network of relevant stakeholders (perhaps including Local Authorities, Universities and technology providers) whom could be approached to provide the necessary quality assurances being sought.

*Q30 Do you agree with our proposals to allow network companies and the ESO to carry over any unspent NIA funds from the final year of RIIO-1 into the first year of RIIO-2?*

We agree with the proposal to carry forward any unspent NIA funds from RIIO-1. We also support the proposal to provide the allowance as a package to be expended by the networks within the five years of the price control period as opposed to fixed amounts in each of the five years. This allows considerably greater flexibility in project delivery and potentially for the inclusion of slightly larger projects within the NIA portfolio.

*Q31 Do you agree with our proposal that all work relating to data as part of innovation projects funded via the NIA and SIF will be expected to follow Data Best Practice?*

In principle this seems reasonable although it should be considered whether it is proportional and shouldn't have the consequence of slowing the process down or rejecting projects that are of clear benefit to consumers and stakeholders.

#### Increasing competition

As this consultation relates specifically to the Gas Distribution and Transmission sectors, and ED is subject to its own ongoing RIIO-2 framework development, we will respond in greater detail to the SSMC rather than specifically to questions 32 and 33 set out in the DD consultation.

We do note with interest the proposals to introduce both early and late competition to all eligible projects which are funded via uncertainty mechanisms. We also note that it appears to be Ofgem's intention to approve company's proposed design which appears to be a greater involvement beyond Ofgem's traditional role as economic regulator especially when we note the diverse and complex broad range of options and decisions that might be brought to Ofgem to review.

In the case of the ESO's Early Competition Plan (ECP), due February 2021, we believe it is too early to be able to provide any detailed or sufficiently informed views at this time, however we will closely follow the process and await further visibility on views of how any ECP could be applied to ED. Given the ECP is due at a time where DNOs will be close to finalising their RIIO-ED2 business plans it is important that this interdependency is clearly recognised and late changes to Business Plan Guidance are avoided.

## 8 Approach to the Totex and Business Plan Incentive Mechanisms

We have not answered questions 34, 35 and 36 as we seek not to influence the decisions that are made for individual companies, our comments are limited to high-level policy points where these apply to individual sectors or the energy sector as a whole.

It has been clear that there has been a lack of understanding and clarity surrounding the BPI and the process of its assessment. This is not limited to the timing and depth of guidance provided to companies. Ofgem should seek to avoid the BPI becoming a skewed incentive where companies only aim to avoid significant downside penalties where the observable and achievable upside is much smaller. This will reduce companies ambition where compliance with the guidance is the goal thereby reducing the potential overall outcome for consumers.

We also have reservations that the interaction between stages 3 and 4 of the BPI as well as the calibration of the TIM and the materiality threshold for re-openers has been full considered. We welcome that the TIM for GDNs has retained some of its incentive strength, but consider the TIM set for the transmission companies, if applied to other sectors, would risk less delivery of improved outcomes for consumers in RIIO-2 and beyond due to low sharing factors.

We welcome that more clarity and guidance as to the approach to BPI and CVP for ED2 is being consulted on as part of the SSMC and urge that lessons are learned from these DDs to improve the outcome for all stakeholders as part of that process.

*Q37 Do you agree with our overall approach regarding treatment of CVP proposals?*

It has been clear through industry discussions and workshops that there has been uncertainty over the CVP element of the business plan guidance and this has manifested itself in the outcome of the DD proposals.

It is now clear from the DD proposals that this disconnect between Ofgem's expectation, many stakeholders, customer engagement groups and companies understanding which has resulted in a larger than expected number of CVP proposals presented, yet a very small number assessed as meeting criteria, and an even lower number considered worthy of a reward. This will not have been helped by the iterative approach to Ofgem producing business plan guidance.

We expect lessons to be learned for the ED process from this experience so that both DNOs, stakeholders and Ofgem can have a more positive experience, underpinned by clearer guidance on expectations and method of assessment. DNOs are working together collaboratively on a convergence project on how Social Return on Investment or SROI can be standardised. We urge that Ofgem consider the output and progress of this project and how this can enhance CVP assessment for RIIO-ED2.

*Q38 Do you agree with our proposed clawback mechanism to treat received CVP rewards?*

It is appropriate that companies are held to account for delivery against the proposals in which they received a reward for and in the case of non-delivery a clawback to be in place, but this needs to be clearly defined and developed in consultation with companies and stakeholders. It is positive to see Ofgem noting that alternative methods of delivering the same outcome will be considered as part of this and also accepting that circumstances do change, and companies may identify better ways of delivering outcomes for customers.

We would add that it is important (as in the case of all items which are subject to assessment at closeout) that the closeout report requirement must be scoped up in conjunction with companies and stakeholders ahead of the price control commencing, ideally before business plan submissions and certainly before Final Determinations. It is crucial that Ofgem avoid the temptation of leaving closeout mechanisms to be drafted during the price control as this brings risk to both companies and customers and also risks external factors further delaying completion of work, as is evidenced by recent need to defer the RIIO-1 closeout methodology for GD/T due to the COVID-19 pandemic<sup>13</sup>.

## 9 Interlinkages in RIIO-2, post appeals review and pre-action correspondence

*Q39 Do you have any views on the interlinkages explained throughout this chapter?*

We would make two points as to the interlinkages described in the chapter.

First, the DDs cover TO's, ESO, GT and GDNs and do not relate to the price controls for ED (RIIO-ED2). This means Ofgem must identify any specific interlinkages for ED and consult on its approach during the RIIO-ED2 process. We will then take the opportunity to comment on interlinkages in more detail as part of that process.

Second, while we are encouraged by Ofgem's transparent approach in setting out its views on interlinkages, we are concerned that Ofgem is influenced by the possibility of CMA appeals and is seeking to preserve additional flexibility as a means to protect its position in such appeals. For that reason, we think it is helpful to be clear as to how interlinkages should play into an appeals process.

The most helpful source on this is the view expressed by the CMA in its letter to Ofgem of 30 October 2019. The CMA explained:

- in accordance with previous appeal determinations, the CMA will take interlinkages into account;
- regulators should explain these interlinkages, and the reasons for them, in their decision documentation;
- an appellant cannot "cherry pick" just one specific unfavourable component of a regulatory decision where that is not in practice a separable decision; and
- the overall price control is the combination of a number of individual decisions, and it is not beyond the CMA's powers to review these individual decisions, on the basis that they need to be considered "in the round" with decisions that are otherwise unconnected parts of the regulatory settlement.

We think this position is clear. Where there are interlinkages, Ofgem needs to specify them and do so clearly, and not just refer in general terms to "in the round interlinkages" at a very high level. To the extent interlinkages inform decision making, we would expect Ofgem to state clearly the interlinkages and the effect that they have had. Where Ofgem does so, and there is an appeal, the CMA is well able to consider those interlinkages, including those which need to be considered "in the round". Altogether, this ensures that any appeal focuses on the right issues, and all the right issues, and does

---

<sup>13</sup> Covid-19: Amendments to RIIO-1 Network Price Control Processes for 2020, page 5, Ofgem, May 2020

not result in any party considering that matters remain “unresolved” at the conclusion of any appeal process.

*Q40 Are there other interlinkages within our RIIO-2 package that you think are relevant to the three pillars identified in this chapter?*

We have nothing to add in response to this question.

*Q41 Do you have any views on our proposal to include a statement of policy in Final Determinations that in appropriate circumstances, we will carry out a post appeals review and potentially revisit wider aspects of RIIO-2 in the event of a successful appeal to the CMA that had material knock on consequences for the price control settlement?*

We understand that Ofgem’s position is that “in appropriate circumstances, we will consider whether to review wider aspects of the price control settlement following the conclusion of a successful appeal to the CMA. The aim of such a review would be to ensure a coherent regulatory settlement is maintained in the event the CMA’s decision has material knock on consequences for the wider price control settlement.”<sup>14</sup>

Ofgem gives two examples of where it envisages a post appeals review may be carried out. These are:

- “The CMA quashes the decision(s) appealed and remits to Ofgem for reconsideration with a direction that Ofgem reconsider the decision and consider interlinkages; or
- The CMA quashes the decision(s) appealed, retakes the decision itself but directs Ofgem to consider interlinkages.”<sup>15</sup>

Ofgem suggests this is not an exhaustive list, as it is difficult to set out possible future scenarios. The key issue from our perspective is whether Ofgem is intending to leave open the possibility of post appeals reviews in circumstances where it has not been specifically directed to (re)consider a matter by the CMA.

If Ofgem is clarifying that it will do as directed, then we do not consider that any policy statement needs to be made. A policy statement setting out that Ofgem would comply with the binding directions of the CMA is otiose.

If Ofgem is intending to leave open the possibility of further post appeals reviews, Ofgem should be explicit about its intentions, to allow parties to engage meaningfully. That said, if this is Ofgem’s intention, the comments provided by ENWL in its March 2019 response to Ofgem’s Cross-sector questions would continue to apply. We elaborate on those points below.

- The appeals regime is not there to safeguard a ‘settlement in the round’. Its purpose is to allow licensees to seek redress where Ofgem has made errors so as to allow for necessary corrections to be made. This is consistent with the EU Third Energy Package requirements that Member States “ensure that suitable mechanisms exist at a national level under which a party affected by a decision of a regulatory authority has a suitable right of appeal to a body independent of the parties involved and of government.”
- The CMA’s powers in determining price control appeals are broad and include quashing the decision, remitting the decision back to the authority for reconsideration and determination in accordance with any directions and substituting its own decision for that of the authority

<sup>14</sup> Core document, table below paragraph 11.30, Ofgem

<sup>15</sup> Core document, paragraph 11.32, Ofgem



and making any such directions as are necessary. As set out in response to Question 39, the CMA is able to consider interlinkages in the appeals process. It is therefore for the CMA to determine whether consequential amendments are required to the price control decision when correcting the error(s) and not for Ofgem, which must act in accordance with the CMA's determination including any directions.

- In circumstances where, further to a decision on appeal by the CMA, Ofgem reopened and reconsidered an aspect that it was not directed to by the CMA, it is highly likely that the parties subject to any further changes would appeal this decision. It cannot be in anyone's interests – least of all consumers – for repeated adjustments to be made to price control settlements. Ofgem would also, in that scenario, need to be aware of the deleterious effect on regulatory certainty, which would increase the risk associated with investing in regulated companies (and so increase licensees' cost of equity).

In practical terms, the perceived threat (that matters will be reopened after an appeal) will mean that the consideration of interlinkages in any appeal process will be vital. As set out in response to Question 39 above, this process rightly begins with the regulator explaining interlinkages in its decision. Ofgem should not seek to reserve to itself the possibility of considering interlinkages other than those raised in its decision or considered in the appeals process. The threat to coherence of a regulatory settlement would only arise if Ofgem does not properly document relevant interlinkages and/or fails to raise them in an appeals processes.

*Q42 Do you have any views on the proposed pre-action correspondence, including on the proposed timing for sending such to Ofgem?*

Ofgem's position is that it "expect[s] any prospective appellant to send pre-action correspondence at a sufficiently early stage after the publication of Final Determinations and ahead of the deadline for making an application for permission to appeal."<sup>16</sup> Ofgem makes reference to the view of the CMA, which we consider is a helpful starting point. The CMA stated:

*"We wish to encourage this pre-appeal conduct [of early, active engagement] as good practice. Where it appears that appellants have acted in a way which, without good reason, makes case management more difficult, for example appellants who fail to engage with the appropriate regulators and notify us and update us about their potential intentions to appeal, this could be reflected in our assessment of their conduct when allocating costs at the end of the appeal, even when such appeals are successful. Ideally, we would prefer such pre-notification to include the potential scope of any appeal, rather than be limited to notification of the potential existence of an appeal."*<sup>17</sup>

While we appreciate that early and positive engagement with the regulator about appeals is a practice to be encouraged, we would be surprised if Ofgem was unaware of the likely grounds of dispute given the degree of engagement during the price control process. Moreover, there are practical reasons why it may be difficult or inappropriate to engage early. In particular, Ofgem will appreciate that deciding to bring an appeal to the CMA is often a finely-balanced decision and companies will want to see the final outcome of the price control process before deciding whether to appeal or not. Ofgem's position, that such pre-action correspondence is "expected" is not clear as to the legal effect envisaged, and it would be helpful if Ofgem clarified its position.

---

<sup>16</sup> Core document, table below paragraph 11.30, Ofgem

<sup>17</sup> CMA Response: Clarification of our position on potential Energy Licence Modification Appeals, paragraph 12, CMA

To the extent Ofgem is seeking to make pre-action correspondence compulsory, we would note that the process for appeals to the CMA is well-established, and laid down in legislation, supplemented by the CMA's rules on energy licence modification appeals (CMA70). Companies should adhere to the requirements of the appeal process. This process has been designed to be fair and workable to both appellants and the regulator. Prospective appellants can decide what, if any, further information they share with Ofgem beyond that which is legally required. It is not for Ofgem to add to or amend the CMA's rules or the statutory process.

To the extent Ofgem is seeking to position the lack of pre-action correspondence as a matter that the CMA should take account of in allocating costs at the end of an appeal, we would note that this too is a matter for the CMA. It cannot be for one party to an appeal to determine the terms on which costs are allocated between parties. In contrast, the CMA's view appears not to place an "expectation" of pre-action correspondence on appellants.

It follows from the above that we have nothing to add on the proposed timing for "encouraged", voluntary pre-action correspondence.

*Q43 Do you think we need specific mechanisms in RIIO-2 to manage the potential longer-term impacts of COVID-19? If yes, what might these mechanisms be?*

A global event with the impact that COVID-19 has had is unprecedented. The timing of Gas and Transmission business plan submissions in December 2019 means that these plans won't have been able to reflect COVID-19 impacts.

In operating our ED business, at the time of this response in September 2020, we are still assessing the medium and longer-term implications of COVID-19. In the short term, through the COVID-19 restrictions, we have found our agility, the commitment of our workforce and supply chain and by listening to stakeholders and customers that we have been able to continue to provide a high standard of service, throughout the period to date. We also continued, in response to customer and stakeholder needs to provide new connections where safe to do so as well as sustaining the delivery of our maintenance and resilience programmes of work. We took the view from the start of the COVID-19 restrictions that safety of employees and the public is paramount, but also our vital services would be even more critical, especially if COVID-19 impacts on our customers continued into the winter months.

Inevitably, whilst focussing on customer needs, the rapid changes we made to our business to ensure that vital services continued as seamlessly as possible have led costs to increase. For example, simple changes we've made, like we now use both our existing company vehicles and staff's own cars paid company mileage so that staff going to fix power cuts don't travel together for extended periods. We've also been doing different mixes of maintenance work as certain jobs we need to do offer better ability to protect the public and our workforce social distancing compared to the most efficient, optimised programmes we'd normally undertake. Under the ED1 Totex Incentive Mechanism the increased costs are shared with customers and shareholders. At the scale these costs to date have been incurred to date, we don't currently think action is needed by Ofgem in our current price control to address any shortfalls in allowances. It's too early to say even now what the enduring impacts might be on our costs and service levels. For example, it is unclear to what extent we will return to the, "old pre COVID-19 normal". **Therefore, we expect Ofgem will want to be able to take into account new evidence from GD/T companies on COVID-19 impacts and take these into account when setting final determinations.** In our case, as an ED company, our separate process is running about 2 years later. So, we expect to be able to more effectively assess and evidence the medium and longer-term impacts of COVID-19, if material enough on our business and reflect these into our final business plan in December 2021. A decision on in period mechanisms may still need to be made based on the circumstances.

More widely, the working between Ofgem and network companies in response to the pandemic outbreak and subsequently towards supporting customers has been an exemplar of how regulation can work under the RIIO-1 framework. It is important that the overall package in RIIO-2 is mindful of the successes of RIIO-1 for customers and does not impede the decisive and customer focussed actions companies took to protect delivery of vital services, at additional cost, without recourse to Ofgem in advance. RIIO-2 might include no flexibility in the settlement for companies and is much more focussed on companies making cases to Ofgem for new customer and stakeholder requirements and if new risks come to pass. This could be a problematical way to work in the event of similar or repeat COVID-19 type situations in RIIO-2, as Ofgem may be required to take rapid and decisive action directly to enable companies to respond as they have in RIIO-1.

Ofgem should consider the 2020/21 fiscal year carefully as this was affected due to COVID-19 when Ofgem undertakes cost assessment and benchmarking. Additionally, Ofgem should ensure that appropriate indices for changes to costs during the price control are reflective of network company cost changes. The energy networks sector provides essential services and has largely continued through the pandemic. Reference indices for costs might place too much weight on other sectors that have responded differently and have latent capacity in them due to COVID-19. We request Ofgem does not use an unrepresentative index influenced by sectors that have had a down turn and probably therefore won't have the same cost pressures as energy networks. Additionally, ways of working might be altered that affect productivity levels now and the scope to drive future productivity improvements might be impacted. Indeed, the energy sector will likely see relatively more price pressures than much of the rest of the economy as the energy sector offers the opportunity to build back better, investing in infrastructure for long term societal and consumer benefit that commences work to address the decarbonisation challenge. Hence general indexes and measures of cost are likely to diverge from energy sector costs due to the COVID-19 shock's different impact to each sector. To the extent that Ofgem agrees costs through uncertainty mechanisms during GD/T2, these cost submissions can take COVID-19 impacts into account as they are made, meaning it's the base costs most susceptible to COVID-19 change that Ofgem and companies need to consider how best to do any necessary adjustments.