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Dear Sir or Madam

Thank you for the opportunity to respond to the RIIO-ED2 sector specific methodology consultation. Please find below E.ON and npower's response.

Executive Summary:

RIIO ED2 is the first electricity distribution price control since the Government announced the UK's Net Zero law. Because of electricity's pivotal role in decarbonising transport and possibly heat, it is vital that Ofgem and the industry find a price control mechanism that puts the UK on an early footing to delivering this ambitious target. To our mind, decarbonisation has now become as important in setting regulatory revenues for monopoly network operators as security of supply and cost to (and protection of) customers. Therefore, we are very pleased to see Net Zero being the basis for the three key areas of this price control, namely **strategic investment** which will enable mass take-up of electric vehicle and heating, **digitisation** which will ensure that the network is being used as efficiently as possible as more and more low carbon technologies are added and **distribution system operation** which will allow the networks to operate with large quantities of intermittent renewables on the system. We have focussed our consultation response on these three areas. In summary we believe:

- a) **The uncertainty around strategic investment is best informed by using decentralised forecasts where local stakeholders e.g. local authorities can work with DNOs and other 3rd parties to tackle local issues or maximise local opportunities.** Local Area Energy Plans can be used to translate Climate Emergency targets set by local authorities into schemes and projects that DNOs can factor into their Business Plans. We believe that using a centralised approach is likely to miss these opportunities.
- b) A lack of certainty in how customers will engage with Net Zero is the key issue for RIIO ED2. Most of this uncertainty will be around the timing and volume of small-scale projects to invest in the network i.e. tens to hundreds of small projects to increase the capacity on the LV network to allow for mass take-up of EVs. We believe that a simple uncertainty mechanism that allows DNOs to adapt their business plans easily without needing to gain

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Ofgem permission for each individual project is the right methodology to follow. **The proposed capacity volume driver is the best option in our opinion. However, the utilisation strategy incentive needs further work in order to include flexibility directly in the methodology.** As proposed the DNO selects a blend of interventions, including flexibility, to keep peak utilisation within a set band, but this does not consider flexibility's ability to increase overall utilisation of the network i.e. move demand or generation from a peak period to an off-peak period. We are keen to continue working with Ofgem through the Overarching Working Group to find a combination of uncertainty mechanism and incentive that delivers as much certainty of efficient use of bills for the DNO, Ofgem and customers.

- c) **Digitisation of the network is best pursued through an overarching license obligation framework set by Ofgem rather than allowing individual DNOs to set their own digital strategy.** We are supportive of Ofgem's license condition to ensure that DNOs are following the Energy Data Taskforce recommendations and best practise, making all data 'presumed open'.
- d) Optionality over DSO governance needs to be maintained as the argument over DNO's transition to DSOs has not been made. **In order to keep the option of legal separation open, it is vital that DNOs look to keep DSO activities as separate as possible and should definitely not be allowed to 'mesh' DNO activities and DSO functions together such that they cannot be easily split should a decision to legally separate later be made.**
- e) Using the Business Plan Incentive to ensure DSO best practise is consistent across all the DNOs is a good idea. It ensures that those DNOs who have been quiet about local flexibility markets will need to raise their game in order to benefit from the business plan financial incentive.
- f) DSO metrics and performance should be set not just by DNOs but in conjunction with wider stakeholders
- g) **A DSO incentive along the lines of the ESO overarching ex post qualitative incentive that includes stakeholder feedback is an excellent way to ensure that DNOs are providing the market with DSO functions that are useful to all participants and not just DNOs.**
- h) The DSO principles as suggested are broadly correct, but that more thought needs to be given to bringing all sources of flexibility into a single market allowing for better flexibility price discovery. **DNO controlled sources of flexibility (such as ANM and other non-firm connection agreements) need to be set in the same context as flexibility service procurement.** Without this, DNOs will have no reason to look to nurture and build up flexibility markets as they will have access to 'free' flexibility.
- i) **The Access SCR and RIIO ED2 processes together need to address this issue of non-firm access giving DNOs a source of 'free' flexibility that will threaten the nascent flexibility markets that are being formed.**

Overview document questions

OVQ1. 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?

No comment

OVQ2. Do you have any views on the proposed pre-action correspondence, including on the proposed timing for sending such to Ofgem?

No comment

OVQ3. Do you agree with our proposed approach to a Net Zero re-opener?

We appreciate the high degree of uncertainty for the DNOs in incorporating Net Zero into their business plans and therefore, on balance, we agree that a Net Zero reopener should be part of the final determinations. However, we would like to highlight the uncertainty that reopeners add to suppliers in forecasting DUoS charges for multi-year contracts which are common in the non-domestic market. Therefore, suppliers can be exposed to significant additional costs that are difficult to recoup from customers who have signed up to multi-year tariffs. However, a Net Zero reopener allows the industry to take advantage of changes in policy, technology and legal in order to deliver Net Zero as cost effectively as possible. Because the industry has a better overview of these types of changes, we believe that DNOs as a sector ought to be able to call for a Net Zero reopener, rather than having to lobby Ofgem to start the reopener process. Therefore, whilst we agree with most of the Ofgem's proposed approach to a Net Zero reopener, we ask that its impact on the wider industry is considered as well as also allowing the DNOs as a collective group to initiate a Net Zero reopener process.

OVQ4. In what circumstances, would a centralised approach to setting forecasted outputs be appropriate? What form should this take?

We believe that a centralised approach/forecast does not consider regional differences that could have dramatic differences in a DNO's baseline expenditure request. For example, if a local authority is targeting Net Zero earlier than 2050 (through a Climate Emergency Plan) then electrification in that region might proceed quicker than a centralised plan would suggest. DNOs will need to take Local Energy Action Plans (LAEP) into account when setting their RIIO Business Plans, but if Ofgem makes no allowance for this, then Local Energy Action Plans (and hence Net Zero) could be put at risk as the DNO will have insufficient allowance to deliver any necessary investment. We appreciate that Ofgem has the difficult job of deciding which investments that DNOs put forward are really required,

but by trying to use a common approach across all DNOs using a single forecast, this will miss the likely heterogeneous take up of electrification of transport and heating. Regional forecasts, through Distribution Future Energy Scenarios (dFES) based on the national FES, with differing parameters evidenced through independently verified LAEPs should allow Ofgem to treat DNOs on a similar basis when comparing necessary investment i.e. if Oxford and Newcastle both are targeting Net Zero by 2035 then the rise in electric vehicles (and hence any associated increase in electric demand) should be broadly similar.

OVQ5. What would be the factors we should take into account that would give us high certainty in a centralised approach to setting outputs?

As stated in OVQ4, we believe that a centralised approach is not the most appropriate approach because of the high likelihood that regional differences will not be captured in a centralised approach. We believe that the uncertainty in outputs will be much higher if a centralised approach was used.

OVQ6. Alternatively, in what circumstances would it be more appropriate to take a decentralised approach to determining forecasts?

See response to OVQ3

OVQ7. What would be the factors that we should take into account that would give us high certainty in forecasted outputs derived through a decentralised approach?

As stated in OVQ3, a decentralised approach does capture local factors (political, social, geographical, economical etc) which are all important factors in reducing uncertainty. Local authorities should have a clearer picture of how Net Zero can work in their area e.g. the South West might want to concentrate on electrification given the high level of embedded renewables in the area whilst Humberside might focus on supporting domestic hydrogen heating given the likely high demand for industrial hydrogen in that area. Using a centralised approach will miss this potential diversification in focus. DNOs will need to provide significant (that the LAEP or other evidence will mean changes from business as normal), reliable (that local authorities are committed to direct action over the period of RIIO ED2) and independent (inclusion and testing from many stakeholders) evidence that their business plan will support local needs and focuses.

OVQ8. Do you consider that the LAEP Best Practice guidance produced by the Centre for Sustainable Energy and the Energy Systems Catapult provides adequate checks and balances to ensure that local or regional energy plans are robust, unbiased and have broad support?

No comment

OVQ9. Which of the uncertainty mechanisms and incentives in Appendix 3 will be most effective in enabling efficient strategic investment?

Our belief is that a capacity volume driver is the best option of uncertainty mechanism (UM) to enable efficient strategic investment.

An UM based on local plans with triggers would be a very binary mechanism and would only offer support for uncertainty in timing, not really tackling volume uncertainty. The choice of trigger would also become extremely important without really reflecting any increase in certainty. An example where a trigger does not work might be where a LAEP trigger was set at 10k EVs before investment can be included in the allowance. However, the 10k EV trigger assumes that the 10k EVs will have a high diversity factor i.e. they would not all charge at once. If only 9.5k EVs are installed, but these EVs have only a slightly lower diversity factor, the need for investment will be more necessary than the original trigger, but this investment will not be made available as the trigger . Therefore, we believe that trigger mechanisms are not best suited to this type of strategic investment decision making.

A low carbon technology (LCT) volume driver is better suited as a strategic investment UM than the trigger option as it allows a linear increase in investment allowance based on the number of LCT installations. However, the vast range of LCTs will make it difficult to make use of an 'average LCT'. An example where a LCT volume driver will struggle to indicate the correct level of investment required would be an affluent area where most people can afford to purchase electric vehicle capable of rapid charging. If twenty people all purchase rapid charging EVs, this could necessitate significant DNO investment e.g. upgrade of a transformer, but based on an average LCT metric, twenty LCTs might be too low a level to warrant this level of investment.

We believe that reopeners should only be used for 'unknown unknowns' where the DNO could not have been expected to anticipate the need to include investment in their business plan months or years previous. The uncertainty due to the take up of electric vehicles or electrification of heating is acknowledged by all, with the uncertainty being in the timing and level rather any uncertainty in whether it will happen. Therefore, UMs which can be designed and put in place during the RIIO discussions and then left to provide the correct level of investment allowance to the DNOs as and when required are much better suited to efficient strategic investment.

We believe that the fairest and most effective UM is a capacity volume driver based on network utilisation. Rather than using an average cost per LCT (as in the LCT volume driver) which will vary significantly on customer choices, an average cost per MVA is a much better defined concept. Ofgem and the industry have a lot of experience of benchmarking the cost of reinforcement and whilst flexibility markets are nascent today, flexibility markets are transparent and open in order to benchmark flexibility costs.

We are concerned that none of the three incentive options highlighted by Ofgem are sufficient to incentivise DNOs to take flexibility fully into account when making strategic investment decisions. We believe that Ofgem should use RIIO ED2 to strongly encourage DNOs to take a long-term view on investment requirements supported by flexibility to defer major investment decisions until more data (and hence certainty) is available. We do acknowledge the potential misuse of strategic investment to allow DNOs to 'gold plate' networks and oversize them. But where there is good circumstantial evidence (from LAEPs and current uptake of LCTs), flexibility can then support deferral that allows more actual data to be gathered. We believe more work and discussion is needed to deliver an incentive that encourages DNOs to use flexibility to build the case for strategic investment but doesn't penalise them if the final demand didn't warrant a strategic investment. We believe that the utilisation strategy incentive as presented by UKPN to the RIIO ED2 Overarching Working Group has a lot of merit but must be transparent in its blend of interventions such that Ofgem can deem how much flexibility could be used to help. The important aspect of the UKPN utilisation strategy that needs adapting is its focus on peak utilisation and not total utilisation i.e. two networks can have the same utilisation (as defined by peak power divided by capacity) but in one instance the correct intervention is reinforcement where load exceeds network capacity for several hours, but in another instance the correct intervention is flexibility where load exceeds network capacity only briefly.

OVQ10. Do you agree with our proposals to increase levels of BAU innovation?

We agree that DNOs ought to be looking to use baseline allowance to fund innovation, especially where that innovation will lead to reduce operational costs which will then benefit the DNO through the totex system. Separate innovation funding should focus on system wide innovation which would otherwise not have been done as it does not benefit the individual DNO to a sufficient level in order for them to propose it under baseline allowance.

OVQ11. Do you agree with our proposed methodology in relation to the RIIO-2 Strategic Innovation Fund?

Yes, we are fully supportive of the Strategic Innovation Fund and the proposed methodology behind it. We are especially pleased to see the requirement for 3rd parties to be involved such that an external viewpoint can be brought into the area.

OVQ12. Do you agree we should adopt a consistent NIA framework for DNOs, and other network companies and the ESO?

No comment

OVQ13. What are your thoughts on our proposals to strengthen the RIIO-ED2 NIA framework?

No comment

OVQ14. Do you have any additional suggestions for quality assurance measures that we could introduce to ensure the robustness of RIIO-2 NIA projects?

No comment

OVQ15. Do you agree with our proposed approach for setting individual levels of NIA funding?

No comment

OVQ16. Do you agree with our approach to regulating digitalisation and better use of data through the introduction of cross-sector licence obligations?

We believe that the digitisation of the energy system (as well as simple access to network data) are vital components of delivering the overarching financial benefit of a truly flexible energy system (as quantified by Imperial College and the CCC). However, to our mind, the two license obligations proposed (production of a digitisation strategy and a digitisation plan, follow energy data best practise) do not give specific enough guidance on the whole system roadmap to digitisation. Allowing each company to have their own individual strategy will not deliver benefits of scale or compatibility e.g. different platforms/IT systems will make it difficult for systems to communicate with each other. We believe a centralised obligation (such as ECO) where companies work within the parameters laid out by Ofgem would be a better route to a fully digitised system.

OVQ17. Do you agree with the proposals we have set out to support optionality for wider institutional change should we later decide to separate DSO functions from DNOs? How else could the methodology support optionality?

We are fully in support of keeping the option open to separate DSO functions from DNOs. We believe that the case has not been made (in either direction) that DNOs are best placed to provide neutral market facilitation of flexibility markets. Whilst we acknowledge that the DNOs are the only industry participants able to take the DSO process forward in the short term, we believe that RIIO ED2 should look to separate DSO functions as much as possible from the DNO activity such that RIIO ED3 can consider the question of having a separate price control for companies performing DSO activities and functions.

OVQ18. Do you agree with our proposal to use the Business Plan Incentive to encourage companies to reveal standards of performance higher than our baseline expectations in their DSO strategies? Do you agree we should require, where appropriate, all DNOs adopt these revealed standards?

One of the key concerns we have around the DSO transitions is its lack of consistency across the DNOs. Whilst we have seen some DNOs look to

proactively engage with stakeholders and work hard to develop local flexibility markets, some DNOs have been very quiet and appear to be engaging with the process in a very limited fashion. We acknowledge the work progressed by the ENA in terms of signing up all the DNOs to the 'Flexibility First' commitments, but in practise there is a large difference between the progress being made towards smart and flexible distribution networks. Therefore, we agree that to reveal performance across the sector and set expectations that DNOs who are just doing the bare minimum will need to catch up and start to deliver best practise can only be a good thing for consumers. Using the Business Plan Incentive should encourage this behaviour right from the start of RIIO ED2, but Ofgem must ensure that this benchmarking activity carries on throughout the RIIO ED2 period and failure to attain best practise within a set timeframe is financially penalised through the proposed DSO ODI.

OVQ19. Do you agree with our proposal to invite companies to provide metrics and performance benchmarks in their DSO strategies?

We have some concern that asking DNOs alone what metrics and performance benchmarks they should be measured against does not provide confidence to the industry that metrics and performance benchmarks that are important to other industry participants will be included. Examples of this can be seen with the ESO where it has taken a lot of industry lobbying to get metrics such as skip rates recorded and publicised. Therefore, we would look for Ofgem to approach other industry participants directly (not just through consultation responses) as to their views on which metrics and performance benchmarks are important.

OVQ20. Do you agree with our proposal to introduce a DSO ODI in which we would, via an ex post incentive, penalise or reward companies based on their delivery against baseline expectations and performance benchmarks? If so, what criteria and other considerations should we take into account in determining whether we should apply a reward or penalty?

We wholeheartedly support the inclusion of a DSO ODI along the lines of the RIIO ESO incentive scheme i.e. ex post qualitative review partially based on stakeholder feedback. We believe that stakeholder feedback is particularly important to reassure Ofgem that the DSO activities that the DNO are undertaking are helping deliver a smart and flexibility distribution system. The difficulty for Ofgem will be in setting a reward/penalty range that is sufficient to ensure that DNOs give DSO functions the proper level of focus.

OVQ21. Do you agree with our proposal to undertake that ex post incentive performance assessment in the middle and at the end of the price control? Do you think the assessment should be more or less regular?

Given that the DSO role is very new, we believe that DNOs would benefit from more frequent assessment of progress (along with constructive suggestions for how progress could be improved) than once every two years. Given that the ESO performance review is every six months, we believe an annual review of performance would be a better frequency. We

believe that any review should not only cover progress of the three core functions identified by Ofgem, but also progress in the governance 'splitting' of the DSO activities from DNO activities.

OVQ22. Do you have views on how we might set appropriate values for rewards and penalties associated with the DSO ODI?

Any reward/penalty needs to be sufficiently high as to not allow DNOs to ignore this important part of their role. However, we do not have any information that would be useful in setting such a level.

OVQ23. Do you agree with the DSO roles, principles and associated baseline expectations in Appendix 5? Does it provide sufficient clarity about the role of DNOs in RIIO-ED2? Do you think amendments or additional baseline expectations are required?

In general, we agree with many of the roles, principles and associated baseline expectations suggested by Ofgem. However, we are concerned with the lack of clarity that these expectations give in the area of flexibility through access rights. Currently, all DNOs have large portfolios of distributed energy resources connected via non-firm connections, typically through Active Network Management (ANM) areas. ANM allows DER to connect to constrained networks more quickly and cheaply, but also allows the DNO to curtail output when the system is stressed. Latest data suggests that DNOs have >2.5GW of DER connected via ANM. Whilst the ENA in their recent Open Networks Flexibility consultation¹ suggest that ANM and flexibility procurement are two distinct services (ANM being used to tackle high generation, low demand issues whilst flexibility procurement is used to tackle low generation, high demand issues), we believe that this is missing the fundamental point – that ANM and flexibility procurement are two technologies that can offer the same flexibility for the network. As an example, storage providers can offer demand and generation services to DNOs that would suit both issues described above but are kept out of revenue streams associated with low generation and high demand due to ANM bilateral contracts. The DSO principles defined by Ofgem do not address the issue that non-firm access is a back door for DNOs to procure flexibility without competitive forces finding a true value for flexibility. We believe that ANM contracts should be moved into wider flexibility markets that allow them to compete fairly with other technologies and providers through transparent and consistent tenders.

However, we are fully supportive of many of the baseline expectations including transparency, the requirement of robust evidence, incorporation of uncertainty and optionality in valuations, major improvements into the insight into network development (including end-to-end network planning), a clear dispatch framework developed with stakeholders and improved network operational visibility

¹ <https://www.energynetworks.org/assets/files/ON-PRJ-%20Flexibility%20Consultation%20Paper%202020-PUBLISHED.pdf>

OVQ24. Are there any electricity distribution specific barriers to whole system solutions, and if so, are there any sector specific price control mechanisms to address these?

No comment

OVQ25. Are there any electricity distribution specific issues you think should be accounted for in the Business Plan Incentive?

No comment

OVQ26. Do you agree that whole system solutions are relevant to the innovation stimulus?

We agree that whole system solutions should be a core part of all innovation stimuli

OVQ27. Do you agree with our key proposals for the CAM?

We agree that the CAM is a good first step to encouraging network companies to work closely with other industry participants (including gas) to uncover the best solutions for customers overall and to ensure that parties do not block any such solution due to revenue allowance limitations.

OVQ28. Do you consider that two application windows, or annual application windows, are more appropriate, and should these be in January or May?

No comment

OVQ29. Do you consider that the current electricity distribution licences should be amended to include the CAM, or wait until in 2023 at the start of their next price control?

We believe that the current electricity distribution license should be amended to include CAM as soon as possible so that whole system solutions can be start being developed today.

OVQ30. Do you agree with the impacts of our potential Access SCR proposals that are identified in this Chapter? Are there additional impacts that are not identified?

We believe that the Access SCR will have a significant impact on DNOs preparing business plans for RII ED2. One aspect that is not covered in the sector specific methodology is that allowing non-firm access rights (through the Access SCR) without financially firmness gives DNOs a degree of 'free' flexibility, much in the same way as ANM schemes (see OVQ23). DNOs are looking to maximise this resource at the expense of nurturing the nascent flexibility markets². We believe that DNOs should

² NPG –'Building our plan for 2023–2028 Emerging Thinking – Supporting Material' September 2020

be steered away from this mindset that non-firm access and ANM can deliver much of their flexibility requirement for free and that all these flexibility resources should be put in open and transparent flexibility markets where the value of flexibility can be found fairly.

OVQ31. Do you agree with the proposed Access SCR baselines for the RIIO-ED2 business plan submissions (ie that Draft RIIO-ED2 Business Plan submissions should use Access SCR Minded to Consultation as a baseline, and that Final Business Plan submissions should use Access SCR Final Decision as a baseline?)

No comment

OVQ32. How do DNOs propose to demonstrate the impact of our Access SCR reforms on RIIO-ED2 Business Plans?

No comment

OVQ33. What further guidance might be required from us to allow DNOs to identify the parts of their draft Business Plan submissions that could be impacted by our Final Decision of the Access SCR?

No comment

OVQ34. Do you think we need specific mechanisms in RIIO-ED2 to manage the potential longer-term impacts of COVID-19? If yes, what might these mechanisms be?

No comment