

Response of the CEG for UK Power Networks to Ofgem's RIIO-ED2 Methodology Consultation

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UK Power Networks
**Customer
Engagement
Group**

Response to Ofgem's RIIO-ED2 Methodology Consultation

Introduction

This is the response of the Customer Engagement Group (CEG) for UK Power Networks to the RIIO-ED2 Methodology Consultation. We have responded to the questions insofar as they relate to the Terms of Reference of the CEG for UK Power Networks and to Ofgem's requirements for CEGs.

The response relates to the following consultation questions.

- OVQ1 – CMA appeals in ED2
- OVQ9 and COQ37 – Strategic investment and uncertainty mechanisms
- QV10 – Innovation
- OVQ17 to 23 – DSO transition
- OVQ30 to 33 – Access and charging review

The chair of the CEG has written to the Ofgem CEO to request clarification about some aspects of the consultation that did not give rise to consultation questions.

OVQ1 – CMA appeals in ED2

Ofgem's proposals to "... carry out a post appeals review and potentially revisit wider aspects of RIIO-2 in the event of a successful appeal" represent significant changes from previous practice.

The CEG is not expressing a view about the merits of these proposals.

If and when Ofgem consults on such proposals, the CEG suggests that as well as a stated objective of providing "*further transparency to stakeholders around our decision-making processes and the potential consequences of a successful appeal*", Ofgem should have an explicit intention to consider customer and consumer¹ benefit and detriment as factors in its evaluation. Unless it does so there is a risk that the referral process will remain one-sided and not protect effectively the interests of customers and consumers.

OVQ9 and COQ37 – Strategic investment and uncertainty mechanisms

These are key issues for the networks and for their customers in ED2.

The consultation says little about

- how Ofgem has considered the costs, benefits, risks and mitigations that its various proposals on strategic investment and uncertainty mechanisms (UMs) will have for customers in the near future and the longer term
- how Ofgem proposes to administer the UMs in ED2, including what would trigger reopeners² and other UMs: the nature of the evidence, for example of customer detriment or benefit, that will be necessary and sufficient for Ofgem to pull the trigger and at what level of aggregation the mechanism would apply
- how flexibly UMs, including the net-zero reopener, can be administered in the context of the speed and pathway that different customers and localities might want to adopt to transition to net-zero energy systems

¹ For the purposes of this consultation response, 'customer' refers to a bill payer, while 'consumer' refers to energy users, some of whom are not bill payers.

² In considering reopeners (A3.8) Ofgem should not limit the technologies. It is possible that traditional electric space heating could provide a more economic low carbon solution for some customers than, for example, heat pumps.

- how the mechanisms will work in the context of the constraints of government policy, the net zero target, the post-Covid situation, the need for whole system, local solutions and the extensive set of other outcomes and targets set out in the consultation.

We think that the methodology should be clearer on these points and set out how Ofgem plans to measure and monitor customer detriment. In addition, it would be helpful if Ofgem were to say more about how it expects the CEG to challenge, from the customer perspective, the proposals put forward by UK Power Networks.

The CEG believes that the local engagement and planning will be necessary to achieve efficient routes to net zero. We acknowledge it is unlikely that we will have this by the start of ED2 but strong local engagement with customers and stakeholders will lead to the best way forward. Unless Ofgem supports and incentivises this direction, including a leadership role for the DNOs, ED2 will achieve less than it should.

QV10 – Innovation

To achieve net zero, the extent of innovation that will be needed across the energy networks and customers is thought to be unprecedented and the groundwork will have to be laid in the ED2 period. Ofgem's main objectives in the consultation are to drive innovation as business as usual and large-scale innovation projects.

The consultation describes a complex set of arrangements and relationships to deal with innovation in the sector. This raises important questions of leadership, role clarity and responsibility.

The CEG is responding to this question because the consultation includes a specific proposal that the CEGs should “... *challenge the level of ambition within the companies' innovation strategies*”. We presume this is in a context where Ofgem would like UK Power Networks' innovation proposals to be more rather than less ambitious, and that this would entail a higher level of risk.

The CEG intends to challenge UK Power Networks' plans for involving customers in innovation and its use of the results of its customer research and stakeholder engagement to direct and drive innovation. We will undertake a critique of the coverage of innovation in UK Power Networks' research and engagement and the extent to which the results are factored into the business plans for the three regions. In doing this we will have regard to differences between and within UK Power Networks' licence areas.

Evaluating and measuring the effects of innovation programmes and initiatives is well known to be problematic. There are intractable issues about risk, acknowledging long-term benefits, double counting, additionality and unintended consequences. An additional issue for a regulated network is that it can anticipate a capped benefit from innovation incentives for one price control period only. This makes radical innovation unattractive to a DNO and its customers and undermines the idea that innovation can be embedded in business usual.

We think that the methodology should go further than the consultation including a statement of how the risk associated with ambitious innovation should be considered and proposals for how the CEG can effectively challenge innovation plans from the customer perspective.

OVQ17 to 23 – DSO transition

Ofgem says it wants to give consumers a stronger voice and put it at the heart of ED2. As well as being the recipients of the outcomes from the power system, consumers and their flexible behavioural

responses contribute to efficient solutions and the DSO. As well as changes in the way the system operates, flexibility solutions require behavioural changes and investments on the demand side.

This being so, the CEG was disappointed to note the limited references in the consultation to customer and consumer behavioural issues. The references in the consultation to behavioural issues and the use of flexibility relate only to the companies.

Relevant customer side considerations include the following.

- Customer behaviours and new roles for customers – While the regime may have a limited record of encouraging such responses in the past, they will have a significant part to play in an efficient path to net zero. They will be key considerations for the CEG when looking at the options and expenditure proposed by UK Power Networks.
- Flexibility – The consultation talks about this in terms of its use by and benefits to the networks and its questions are about this side of the market. Such benefits will arise from investments and changes in behaviour adopted by energy customers. How such changes arise and are encouraged and enabled by the DNOs, among others, will be important in the transition and will affect how the CEG judges UK Power Networks' plans.
- It is not clear how Ofgem envisages that the risks, costs of flexibility and related changes will be allocated in ED2. For example, what will be their effects on bills for customers and customer segments, including customers in vulnerable circumstances and those that cannot be flexible in their energy use? Community energy schemes might expect benefits to accrue locally, another significant consideration for the CEG.

Similar considerations apply to DSO matters generally. They may affect customers substantially but Ofgem's proposed focus is mainly on technical company side considerations.

We think that the methodology should go further than the consultation and say how Ofgem expects the CEG to challenge the ambition of UK Power Networks' flexibility and DSO proposals from a customer perspective, including how the risks and benefits should be considered.

OVQ30 to 33 – Access and charging review

The CEG has limited information about the likely timing and coverage of the results of Ofgem's access and charging review. The possibility that the results of the review might lead to additional work for the CEG and UK Power Networks late in the ED2 process is a cause of concern.

Will Ofgem provide up-to-date information on

- the progress of the review?
- the timing and likely implications of the results?
- how it expects the CEG to deal with any implications of the review within the timetable it has set?