
ADE Response to the RIIO-ED2 Sector Specific Methodology consultation | Oct. 2020

Context

The Association for Decentralised Energy welcomes the chance to respond Ofgem's **consultation on the RIIO-ED2 Sector Specific Methodology** for electricity Distribution Network Operators. The ADE is the UK's leading decentralised energy advocate, focused on creating a more cost effective, efficient and user-orientated energy system. The ADE has over 160 members active across a range of technologies, and they include both the providers and the users of energy. Our members have particular expertise in demand side energy services, including demand response and storage, as well as combined heat and power, district heating networks and energy efficiency.

This consultation response is structured as follows. First, we provide a list of key priorities for the RIIO-ED2 price control that would help to deliver the flexible, low-carbon, resilient system of the future. We then respond directly to the consultation questions most relevant to our members.

Key asks for RIIO-ED2

Market Design

Recommendation 1: All DNOs should put in place flexibility markets procuring standard products across three timeframes (different timescales will be essential in allowing different assets to participate):

- Day-ahead market for constraint management and reactive power to relieve real-time constraints and reduce need for renewable curtailment
- 1-2 year ahead market for reinforcement deferral
- Yearly market for long-term reinforcement avoidance, procured as reserve capacity and used closer to real-time, with contracts awarded on a rolling basis as providers continue to dampen demand

Long-term contracts are not efficient, particularly in the context of falling tender prices, and therefore should not be tendered, unless there is a very strong reason to do so.

Recommendation 2: Any additional, regionally specific needs should be addressed through targeted local products, potentially developed via innovation projects, using standard parameters to determine what, when and how flexibility should be provided to accurately reflect network needs. All innovation projects should be conducted in a transparent manner with stakeholder involvement, as required by the Clean Energy Package. Any potential implications

of regionally specific products for flexibility offered in existing markets should be identified and communicated clearly to industry.

Recommendation 3: All DNOS should commit to eliminating non-financially firm connections at Distribution and direct control of flexibility assets (including Active Network Management or DNO control of EV smart charging) to manage network constraints by 2028, and use flexibility markets and products instead. Use of curtailment and direct control should reduce over the RIIO-ED2 period and have reached zero by 2028. This commitment mirrors the ESO's goal of zero carbon system operation and comprises the DNO's contribution to decarbonisation over the RIIO-ED2 period.

Recommendation 4: All ANM contracts should be migrated to financially firm connection contracts where operation is managed through tradable constraints markets by 2028. A 'red, amber, green' approach should be taken, assessing where tradable flexibility markets can replace ANM contracts in the short term (the 'amber' areas) and where this will take longer (the 'red' areas). A fixed, declining cap on curtailment for all generation on ANM contracts should be introduced, with usage time-limited and standardised, both in terms of costs and numbers of curtailments.

Recommendation 5: DNO flexibility markets and services should be designed to be open to all technologies that could provide the required service and in consultation with industry, as mandated by the Clean Energy Package. Common standards should be put in place with regard to market design, judgement criteria in tenders, interoperability and security standards, and approaches to dispatch.

Recommendation 6: All DNOs should allow a standard 1-year lead time to indicate likely flexibility requirements. For reinforcement deferral, DNOs should allow a 1-2-year lead time between contracting and delivery of flexibility services to allow aggregation and/or construction of flexibility.

Recommendation 7: A single, portal should be shared by all DNOs for prequalification and registration of assets. This portal should be as automated and user-friendly as possible, allowing type testing of assets and portfolio-level testing, including objective pass/fail criteria for all parameters and containing as few manual information inputs as possible. The portal should be independently owned and managed and allow open access to commercial marketplaces and independent Flexibility Platforms.

Recommendation 8: Processes, such as dispatch signals from DNOs to aggregators, should happen in an automated, scalable manner which allows multiple small assets to be dispatched concurrently and in merit order. The approach to dispatch should be standardised across DNOs, either through APIs or standard systems, to ensure that providers do not have to invest in multiple bespoke platforms or systems. Further consideration is also needed of how dispatch instructions will work across DNOs and ESO.

Recommendation 9: DNOs should ensure that no unjustified barriers exist to service provision, removing any unjustified exclusivity clauses and reviewing historic connection agreements to establish whether any restrictions in those agreements are still required.

Recommendation 10: DNOs and ESO should establish clear service prioritisation rules to dispatch, moving to auto-reconciliation of dispatch instructions as soon as possible, with providers fully rewarded for providing responses that fulfil multiple system needs simultaneously.

Recommendation 11: Work undertaken by DNOs should not preclude, and where possible should support, innovative offerings, including independent trading platforms.

Recommendation 12: A Distribution Design Authority should be established to allow industry stakeholders to co-design any information systems or IT infrastructure that will be used to underpin flexibility markets or services.

Valuing flexibility correctly

Recommendation 13: All DNOs should be mandated to use a common, published evaluation methodology for flexibility v. reinforcement decisions. The methodology should appropriately incorporate option value, per day value to customers of faster connections and value of faster rollout of low-carbon generation.

Recommendation 14: DNOs should publish a cost-benefit analysis for all decisions to reinforce the network, rather than procure flexibility, using a standardised template approved by Ofgem.

Recommendation 15: When conducting market tests, as required by the Clean Energy Package, DNOs should run multiple tenders for flexibility services, allow sufficient lead times, ensure that services requirements are designed to minimise costs to providers and offer sufficient volumes to attract interest. A Code of Conduct, outlining the correct approach to market tests should be designed by Ofgem, the ENA and industry and DNOs mandated to follow it.

Recommendation 16: DNOs should be given explicit incentives based on the speed of connection.

Data and Transparency

Recommendation 17: DNOs should adopt a presumed open approach to data, as recommended by the Energy Data Taskforce, with all data made publicly available in accessible formats via a universal catalogue of data sets.

Recommendation 18: By the start of RIIO-ED2, all DNOs should take a signposting and forecasting approach to publication of future system requirements, such that flexibility providers can clearly understand where flexibility services will be needed and have sufficient information to take a credible view on likely revenues.

Recommendation 19: DNOs should adhere to the requirements of the Clean Energy Package in relation to transparency of pricing and utilisation rates, publishing the results of all DNO tenders in accessible formats, with similar details included to those in the STOR tender results.

Recommendation 20: All DNOs should publish in real-time, on an anonymised basis, the locations where providers are being dispatched and the volumes that are being dispatched for.

Recommendation 21: All DNOs should publish the average number of times providers are dispatched in each procurement zone per year.

Recommendation 22: All DNOs should be mandated to share all information on the location and characteristics of DERs and all other network data needed to carry out any DSO function that could potentially be undertaken by a commercial provider.

Recommendation 23: DNOs, or any flexibility market operator in the future, should create a Digital System Map, then release GIS mapping of electricity zones where flexibility may be required.

Recommendation 24: DNOs, or any flexibility market operator in the future, should include sufficiently detailed categorisation in contracts to allow them to estimate the carbon content of each aggregated unit providing balancing services and to publish this data. This should be measured separately in terms of availability and utilisation, and both figures should be reported.

Neutral market facilitation and competition for DSO roles

Recommendation 25: DNOs should tender for system needs as Neutral Market Facilitators; they should not be allowed to provide services where clear commercial alternatives exist, including owning and operating storage and providing services like CLASS in line with the Clean Energy Package.

Recommendation 26: Ofgem should ensure that no element of RIIO-ED2 prevents DSO functions from being put out to competitive tender at a later date. Assessment of which functions could be put out to tender should be completed before the start of the RIIO-ED2 period, if possible. Any tender should be open to all commercial providers and DSOs and sufficient data should be publicly available to allow competition on level terms.

Recommendation 27: Ofgem should require all DNOs to organise their governance structures such that DSO functions can be easily separated out in the future if necessary. This would involve, for example, having separate heads of DNO and DSO activities, an approach that Western Power Distribution have already implemented.

Recommendation 28: Operation of any network asset funded through NIA or RIIO funding should be contestable, with third parties bidding into an open tender

Whole system outcomes

Recommendation 29: Ofgem should take an active role to ensure that DNOs fulfil their license condition to coordinate with the ESO in design and operation of flexibility services, including communication of needs – the ADE supports the introduction of the coordinated reopener to help enable this. DNO-connected flexibility should be able to participate in the BM and in balancing services as a BMU if it chooses to.

Recommendation 30: Ofgem should design and introduce via RIIO-ED2 a financial mechanism to reward any DNO action that creates a saving for another DNO or the TO

Recommendation 31: Ofgem should ensure that there is clarity on the transition from the current environment, including the Targeted Charging Review and Access SCR, to the future environment of the end of the RIIO-ED2 period in 2028. It is essential that there is a clear pathway, timetable and analysis of the relationships between different policy changes. This should consider where policy and market conditions need to be in 2028 in order to deliver net zero in 2050, and how to measure this.

Consultation Questions & Responses

Net Zero and Innovation (CHAPTER 4)

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

The ADE welcomes the introduction of a Net Zero reopener. It is important that DNO strategic investment is aligned with a clear net zero goal, mirroring the ESO's Net Zero System Operation by 2025 goal; the ADE will engage with Ofgem on this topic.

OVQ4-7: Centralised/decentralised forecasting

- **OVQ4:** In what circumstances, would a centralised approach to setting forecasted outputs be appropriate? What form should this take?
- **OVQ5:** What would be the factors we should take into account that would give us high certainty in a centralised approach to setting outputs?
- **OVQ6:** Alternatively, in what circumstances would it be more appropriate to take a decentralised approach to determining forecasts?
- **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?

The ADE does not have specific comments on these individual questions, but would like to submit a general remark regarding centralised vs decentralised forecasting.

The ADE supports a decentralised approach, with DNOs working actively with Local Authorities and others to understand regional growth and decarbonisation pathways. However, critical scrutiny by Ofgem of any decentralised forecasts is essential, to avoid unjustified over-build by DNOs. Ofgem should support flexibility first, allowing DNOs to invest in significant reinforcement only if Ofgem is satisfied that the DNO has fully exhausted flexibility tenders.

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?

The ADE considers that the LAEP Best Practice guidance provides a good basis for the development of local/regional energy plans.

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

The ADE considers that a variety of well-designed uncertainty mechanisms will be relevant to address the uncertainty inherent to contemporary circumstances.

Firstly, volume drivers, particularly for LCTs, will be crucial. The ADE supports the work done by NGET that transparently set out the distribution of actual project costs in RIIO-1 and how different unit cost metrics would have rewarded the company. Clearly, the ideal is ensuring that the companies have as far as possible a 50:50 chance of being over and under the unit cost set. The ADE would encourage the DNOs to undertake similar analysis as NGET has done.

The ADE also supports the proposed introduction of a capacity uncertainty mechanism to differentiate by network utilisation. It is important that the unit costs for different tiers of network utilisation are set carefully to ensure the companies are not more likely to underspend if reinforcing relatively under-used network. It is also very important that this is accompanied by strong incentives to increase network utilisation, as Ofgem have proposed.

Overall, while we support the mix of incentives set out in the RIIO-2 price controls, so far, and support the continued use of totex, it remains uncertain how effective these will be, and there will be important learnings to draw from the ESO's new model, as we go through RIIO-2, which will be relevant for the treatment of uncertainty in relation to DNOs (e.g. creation of new markets). It is therefore essential that Ofgem has the ability to make use of re-openers to make adjustments and to add new incentives or uncertainty mechanisms to accelerate system operations part-way through the ED2 period.

(See also response to question COQ37, below).

Modernising Energy Data (CHAPTER 5)

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

Yes; the ADE welcomes Ofgem's proposal to introduce data license obligations. A licence obligation requiring the treatment of data as "presumed open" is particularly positive. Network data from DNOs should be available to providers of flexibility services and to consumer groups to encourage development of new energy services for the benefit of consumers and the energy transition.

Digital, whole-network, real-time monitoring of flows and constraints would enable more efficient network planning and management, as well as unlocking wider whole-market benefits such as locational marginal pricing. It is important that this monitoring data does not only highlight areas of constraint or potential constraint, but covers the entire network. Publishing where the network is underutilised will enable the industry to identify where there is potential for LCT installations and demand turn up opportunities. We recognise the need to ensure that this does not lead to excessive costs for consumers, and it is our view that there are ways in which this can be done cost effectively by working with industry. See also response to OVQ23 and COQ22.

Ofgem should consider how to ensure that Digitalisation Strategy and Action Plans are transparent on what data will be prioritised and what form it will take, and what mechanisms can be used to ensure that the Plans are sufficiently ambitious.

DSO transition (CHAPTER 6)

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?

The ADE welcomes the emphasis on ensuring the possibility of future separation of DSO functions from DNOs. The separation of costs associated with DSO roles is a good first step, together with the example, under baseline expectation A5.27, of ring-fencing particular teams to address conflicts of interest. Wherever possible, all elements of the price control relating to DSO roles, such as any incentive mechanism, should be separated out to support optionality. The ADE would welcome stronger direction by Ofgem to require separation in governance structures e.g. as seen with WPD introducing separate heads of DNO and DSO.

See also Recommendation 26 above.

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?

The ADE supports the proposal to use the BPI to encourage DNOs to exceed the baseline expectations. However, the ADE also considers that Ofgem should strengthen the baseline expectations to provide more prescriptive direction, where these are likely to be common across DNOs. See also response to OVQ23.

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

The ADE agrees with Ofgem's proposal, and we look forward to providing further feedback on individual DNO Business Plan consultations.

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?

The ADE welcomes the introduction of a DSO ODI based on performance against the baseline expectations.

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?

The ADE considers that performance should be assessed at least in the middle and end of the price control, but would support more frequent (e.g. annual) assessment.

The ADE recommends that a performance panel be established to carry out the ex post performance assessment. This could look similar to the ESO Performance Panel, which offers a number of benefits. Notably, it provides direct accountability to ESO customers, and strong financial incentives ensure that the ESO takes it seriously. Moreover, the performance panel approach supports improvement in areas, which are difficult to quantify or define numerically (e.g. effectiveness in reforming markets to support new entrants).

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

Rewards and penalties must be high enough to strongly incentivise DNOs to deliver – and surpass – the baseline expectations.

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?

The ADE welcomes Ofgem's baseline expectations, particularly around market development and network operation; if DNOs are strongly incentivised to deliver and surpass these expectations, development of liquid flexibility markets at Distribution will be facilitated. Please see our detailed recommendations, set out in the first part of this document.

Several references are made in the baseline expectations to non-firm connection agreements. It is critical that use of non-firm connections, Active Network Management (ANM) and other implicit flexibility services by DNOs are explicitly, transparently and fairly defined, or transferred to DSO activities. Failure to do this continues to undermine the development of a competitive flexibility market.

ANM and demand side flexibility services should not be treated separately. ANM schemes should be pushed toward a unified, liquid flexibility market with DSR and ANM competing to offer demand services. Otherwise, networks companies access ANM as a unilateral curtailment option. ANM and demand side flexibility are different technologies providing the same outcome and should be treated singularly in a centralised functioning and competitive market (see also recommendations 3 and 4).

Role 1: Planning and network development

The ADE welcomes Ofgem's expectation for increased roll out of monitoring equipment. It is crucial that any requirement to demonstrate net value to customers of investment in monitoring equipment is applied appropriately, and does not stifle important advances in monitoring and data collection. However, as stressed above (OVQ16), we recognise the need to ensure that this does not lead to excessive costs for consumers, and it is our view that there are ways in which this can be done cost effectively by working with industry.

Collection of real time data on network utilisation and constraints will be critical to unlocking the full potential of flexibility services to address network constraints in real time. Flexibility solutions depend on DNOs' ability to understand the exact magnitude and timing of flows and constraints by measuring these in real time.

See also response to COQ22.

Role 2: Network operation

The ADE welcomes the emphasis on economic and efficient dispatch of flexibility, the need for availability and sharing of data between ESO and DNOs to manage conflicts, and the need for transparent and objective rules and processes enabling stacking of revenues (see also Recommendation 10, above).

We strongly support Ofgem's expectation that DNOs should not have direct control on customer assets except in exceptional circumstances. It is essential that the circumstances in which DNOs are able to directly dispatch customer assets are extremely limited and clearly defined, with any direct dispatch being priced at a high enough price (e.g. VoLL) to ensure that it is only ever used as a genuine last resort. See also response to FQ21.

Role 3: Market development

The ADE agrees that DNOs must act as neutral market facilitator (see Recommendation 25), and welcomes the expectations around data and information under A5.24 (see Recommendations 17-24).

We would welcome further expectations for DNOs to provide the following data:

- Real time management of feeder capacity
- Real time feeder headroom/footroom
- Real time feeder voltage
- Asset health indices
- Losses recorded at substation level
- Regional / Local RoCoF

A Whole system approach

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?

Allowing DNOs to tender into ESO commercial markets does not fit well with whole-system solutions underpinned by strong data-sharing between the ESO and DNOs.

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

Yes.

OVQ27: Do you agree with our key proposals for the CAM [Coordinated Adjustment Mechanism]?

The ADE supports Ofgem's proposal to introduce a whole system reopener. We would welcome consideration of how this reopener could be extended to allow reallocation of responsibilities from the DNOs to third parties, including commercial providers and the ESO.

Access SCR

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?

The ADE considers that the Access and Forward-looking charges review will have a significant impact on DNOs and those connecting using the networks from 2023. However, the review is likely to only partially meet the requirements for genuinely smart distribution system operations, with regards to access rights and forward-looking charges. It is therefore important that Ofgem, the DNOs and industry now start to establish how network charging should continue to develop over the RIIO- ED2 period and a vision for the network charging framework needed by the late 2020s.

OVQ31: Do you agree with the proposed Access SCR baselines for the RIIO-ED2 business plan submissions (i.e. 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?)

The ADE agrees with the proposed Access SCR baselines for the RIIO-ED2 business plan submissions. However, these should be taken further, providing the starting point for continued developments throughout the ED2 period to move ANM into liquid markets for flexibility, in order to get us where we need to be post-ED2.

Annex 1 - Delivering value for money services for consumers

Approach to setting outputs and incentives

OUTQ1: Do you agree with our proposal for setting upper and lower limits on the value of bespoke ODIs?

The ADE agrees with Ofgem's proposal. We would encourage Ofgem to ensure the design of bespoke ODIs particularly incentivises proposals that have widespread applicability across the electricity distribution sector.

Meet the needs of consumers and network users: Connections

OUTQ9: Do you agree with our proposal to retain the TTC incentive as a financial ODI in RIIO-ED2?

Yes, the ADE supports Ofgem's proposal to retain the TTC incentive.

OUTQ10: Do you agree with our proposal to include a reopener which allows us to revisit targets, and potentially introduce penalties, in the period?

Yes, the ability to review performance and revise targets will help to ensure continuous improvement over the course of the ED2 period.

OUTQ13: Do you have views on our proposal to use the Business Plan Incentive to encourage companies to reveal higher baseline standards of performance and to apply this, where appropriate, to all DNOs?

The ADE supports this proposal.

OUTQ14: Do you agree with our proposal to use an ex post assessment to penalise/reward companies who fail to deliver their strategies in line with our guidance/exceed performance targets?

The ADE supports this proposal.

OUTQ15: Do you consider that an assessment of performance [against connection targets] in the middle and at the end of the price control is a proportionate approach?

The ADE considers that performance should be assessed at least in the middle and end of the price control, but would support more frequent (e.g. annual) assessment.

OUTQ16: Do you agree with our proposal to retain the Connections GSoPs for all connection customers in RIIO-ED2?

The ADE supports this proposal.

Maintain a reliable network

OUTQ37: Do you agree with our proposal to remove the OEE [Other Exceptional Events] mechanism? If not, what evidence is there to support its retention, and what changes should be made to the existing approach to improve it?

Based on the considerations presented in the consultation document, it seems reasonable to remove the OEE mechanism. It is essential to ensure that any exceptional events mechanisms are very clearly defined and fit for purpose. Given Ofgem's experience of receiving claims under the OEE for events, which were not clearly beyond the DNO's control, and given the noted overlap between OEE and SWEE claims, the ADE considers the removal of this mechanism appropriate.

OUTQ40: Do you agree with our proposal to retain the existing GSoPs [Guaranteed Standards of Performance]? If not, what changes do you think are necessary and what are the reasons for them?

The ADE welcomes Ofgem's plans to review the GSoP regulations ahead of ED2, to improve clarity regarding guaranteed standards of performance.

Annex 2: Keeping bills low for consumers

Disaggregated Cost Assessment

COQ21: Do you agree with our proposed approach on forecasting options for RIIO-ED2?

The ADE recommends a decentralised approach to forecasting (model 1), allowing companies to set their own, well-justified scenarios based, for example, on company DFES. It is essential that such a decentralised approach is based on active engagement with other local actors, reasonably aligned with FES, and accompanied by strict oversight by Ofgem. See also response to OVQ4-8.

Ofgem's emphasis on consistency and transparency throughout this process is welcome.

COQ22: What are your views on our proposal for establishing network impacts and assessing LRE requirements for RIIO-ED2?

The ADE strongly supports a requirement for DNOs to provide better data on network utilisation, and the expectation for DNOs to install more and better monitoring equipment across the network. Collection of real time data on network utilisation and constraints will be critical to unlocking the full potential of flexibility services to address network constraints in real time. Flexibility solutions depend on DNOs' ability to understand the exact magnitude and timing of flows and constraints through real time measurement.

The ADE welcomes the requirement for this data to be made digitally and openly available.

As emphasised in our response to OVQ23, it is important that any requirement to demonstrate net value to customers of investment in monitoring equipment is applied appropriately, and does not stifle important advances in monitoring and data collection.

COQ23: Do you agree with our proposal to compare flexibility solutions and network based solutions evenly in our cost assessment?

Ofgem note that flexibility solutions have different associated costs compared to traditional network based solutions, but do not adequately recognise that flexibility solutions, likewise, offer quite different benefits, making like-for-like comparison unsatisfactory. It is important that the assessment of flexibility against network solutions reflect these benefits. This includes, for example, value to customers of faster connections, value of faster rollout of low-carbon generation, which flexibility enables and, importantly, the value of optionality. See also Recommendation 13, above, and responses to COQ32 and COQ43.

COQ24: How should we treat the fixed costs of procuring flexibility when considering flexibility solutions as an alternative to reinforcement?

Following the first BSUoS taskforce, Ofgem has now accepted the view that balancing costs (including overheads) at national level are fixed costs. The second taskforce has now proposed that such costs are socialised across the demand base. We would expect distribution balancing costs (including overheads) to be recovered in a similar manner.

Cost Benefit Analysis

COQ32: Do you agree with our proposed application of CBA in the appraisal of investment options for RIIO-ED2?

Yes, investment decisions must be based on comprehensive, clear and transparent assessment of all relevant options. It is critical that such assessment is based on appropriate methods for valuing flexibility. The ADE would welcome further guidance for DNOs from Ofgem regarding the valuation of different options. In particular, DNO's should be mandated to use a common evaluation tool, taking into account the options value of flexibility (see also Recommendation 13 and response to COQ23). The ENA Open Networks Project recently consulted on a Common

Evaluation Methodology; as the ADE highlights in our response to their consultation, their proposed methodology does not account for options value, and has further limitations around valuing ANM against flexibility solutions, and thus does not provide a suitable basis for evaluation.

It would be pertinent to include parameter(s) on flexibility in the parameters, which Ofgem expect companies to consider in sensitivity analysis (in relation to paragraph 8.2.6, Annex 2).

Engineering Justification Papers

COQ33: Do you agree with our proposals to retain the requirement for DNOs to produce Engineering Justification Papers (EJPs)?

Yes; in particular, the ADE supports the emphasis on transparency and justification for investment decisions, and their openness to scrutiny and challenge.

Uncertainty Mechanisms

COQ37: Do you agree with our proposed uncertainty mechanisms and their design?

Given the uncertainty inherent to the net-zero transition, uncertainty mechanisms will be an important part of the ED2 price control. The ADE supports the use of a variety of uncertainty mechanisms to address diverse uncertainties and situations. See also our response to OVQ9.

COQ38: Are there any other uncertainty mechanisms that we should consider? If so, how should these be designed?

Overall, while we support the mix of incentives set out in the RIIO-2 price controls, so far, it remains uncertain how effective these will be, and there will be important learnings to draw from the ESO's new model, as we go through RIIO-2, which will be relevant for the treatment of uncertainty in relation to DNOs (e.g. creation of new markets). It is therefore essential that Ofgem has the ability to make use of re-openers to make adjustments and to add new incentives or uncertainty mechanisms to accelerate system operations part-way through the ED2 period.

COQ40: Do you agree with our proposed common approach for re-openers being applied to RIIO-ED2?

The ADE agrees with the need for a common approach for re-openers, to ensure clarity.

Increasing Competition

COQ41: Do you agree that our flexibility proposals are sufficient to incentivise DNOs' native competition?

The ADE considers that the introduction of a DSO ODI, based on the baseline expectations set out in Appendix 5 of the Overview Document, together with the network utilisation incentive will help to incentivise DNOs' native competition. However, it is not possible to say, at this stage, whether these will be sufficient to drive the use of flexibility services for the efficient operation of the networks. As previously emphasised, there will likely be valuable learning to be made, as we move through RIIO-2, and Ofgem's ability to make adjustments to accelerate system operations as required during the ED2 period will be important.

COQ42: Do you believe there are similarities between DNOs running early competitions and the roles and activities that may be related to electricity DSO functions?

While there are similarities, The ADE agrees with Ofgem's view that early competitions have the potential to offer benefits in addition to DSO activities. It is important to consider how the value

of flexibility can be realised at different timescales, including the value of flexibility for long-term network planning.

While the use of early competition begins to enable a longer term view of flexibility solutions, this long-term perspective needs to be made more explicit throughout the RIIO-ED2 price control.

COQ43: Do you agree with our proposed approach on early competition?

The ADE welcomes Ofgem's proposal to use early competition to provide opportunities for flexibility providers and other non-network solutions to demonstrate value against traditional network solutions.

We note Ofgem's considerations regarding criteria for identification of projects for early competition, including considerations regarding timing (e.g. time required to run competitions against time-criticality of the project, as well as considerations around uncertainty of system needs). The ADE recommends a standard 1-year lead time to indicate likely flexibility requirements, as set out in Recommendation 6, above. For reinforcement deferral, DNOs should allow a 1-2-year lead time between contracting and delivery of flexibility services to allow aggregation and/or construction of flexibility.

In assessing projects submitted under early competitions, it is critical that DNOs apply a valuation methodology to correctly assess the value, including options value, of flexibility against reinforcement. All DNOs should be mandated to use a common, published evaluation methodology, appropriately incorporating option value, per day value to customers of faster connections and value of faster rollout of low-carbon generation (see also Recommendation 13 and responses to COQ23 and COQ32).

Annex 3: Finance

Directly remunerated services

FQ21 Are there any reasons why the RIIO-ED2 approach to directly remunerated services should differ from RIIO-ED1?

In general, the ADE does not see any reason to change the approach to directly remunerated services. However, we would like to note our concern with the proposal for DNOs to provide CLASS services as a directly remunerated service. While CLASS provision via market-based mechanisms is marginally preferable to provision as a price-controlled activity, it is the ADE's view that participation of CLASS in balancing services should be prohibited, regardless of the solution. This is for the following reasons:

- DNOs have privileged access to National Grid Control Room planning and actions; including potentially ESO demand and its procurement strategy for reserve and response services ahead of time. This information is not available to commercial participants in these markets. Work to align ESO and DNO Future Energy Scenarios increases the risk that DNOs will be able to access network information, with a resultant advantage when determining their commercial position in balancing services provision
- The proposal that DNOs share profits and losses with consumers clearly risks significant consumer detriment and has the potential to distort DNOs' behaviour. It would also give them a clear and inappropriate competitive advantage in comparison to commercial providers, allowing them to behave like aggregators without needing to seek permission from users or face the same obligations as commercial providers

- There is a clear risk of market domination by the DNOs, as demonstrated in ENW's **initial CLASS submission**, which suggests that the whole of the UK's Frequency Reserve services could be provided by CLASS and a later **presentation on CLASS**, which models 3GW of CLASS deployment in 2027. Other DNOs have also indicated that they will provide CLASS in large volumes if Ofgem's minded-to position is upheld. Market domination could increase the likelihood of system reliability issues in the medium term by crowding commercial providers out of markets, with the result that system reliability is based on an extremely limited pool of providers
- DNOs could face a conflict of interest when connecting new customers to networks where they are providing CLASS, given that connecting a customer under traditional appraisal methods could reduce the normal voltage at the edge of the network, therefore reducing the ability to earn CLASS revenues. An incentive may therefore be created to charge the customer a share of the cost of an upgrade which would enable the DNO to continue earning CLASS revenues, such as installation of larger-diameter conductors; the cost of this connection would be higher than under traditional appraisal methods

More details on each point are available in the **ADE's response to Ofgem's consultation on the regulatory treatment of CLASS**.

For further information please contact:

Caroline Sejer Damgaard, Research
ACE Research | Association for Decentralised Energy

Tel: +44 (0) 20 3031 8757
caroline.sejer.damgaard@theade.co.uk
