

# **RIO-2 Challenge Group**

## **Response to RIO-ED2 Sector Specific Methodology Consultation**

**1 October 2020**

## **RIO-2 Challenge Group**

### **Response to RIO-ED2 Methodology Consultation**

## Introduction

The RIO-2 Challenge Group welcomes the opportunity to respond to Ofgem's RIO-ED2 Sector Specific Methodology (SSM) consultation. This response has benefited from our prior experience in contributing to the development of the other RIO-2 price controls.

The RIO-ED2 price controls have a key role to play in enabling Net Zero and the energy transition. But they come at a time when many consumers, especially vulnerable consumers, are hard pressed to afford their energy bills. The SSM should encourage plans that are ambitious in achieving decarbonisation and energy transition goals at least cost, and deliver reliable and efficient networks. The SSM should ensure that Distribution Network Operator (DNO) plans have:

- robust and consistent demand and utilisation scenarios, presenting a common 'central view'
- robust baseline expenditures, with challenging efficiency targets, and set at minimum levels
- flexible uncertainty mechanisms, enabling adaptive expenditure for Net Zero
- whole system benefits enabled through Distribution System Operators (DSOs), improved data, and non-network solutions
- strong incentives for good customer service, reliability, and environmental performance
- costs of capital that reflect the low levels of risk faced by DNOs
- strong incentives for delivery of robust draft and final business plans, and effective stakeholder engagement.

Our response is presented in two parts:

- this overview document highlights the main points of our response, and draws out what we consider to be some of the most important issues to address for December
- an appendix which addresses Ofgem's detailed question in the core consultation document, and the supporting annexes on outputs, costs, and finance.

## Stakeholder engagement

We strongly endorse the expectation that high quality stakeholder engagement should be regarded as a business-as-usual activity in RIO-ED2. In line with our comments on Ofgem's draft determinations for other sectors, we suggest that Ofgem makes clear in this methodology how it will assess companies' stakeholder engagement in general, and in particular, when it is assessing the merits of any bespoke output proposals.

In this price control, it is particularly important that extensive, systematic stakeholder engagement informs the forecasts and scenarios used by the DNOs. As a result, we suggest that Ofgem specifically sets out its expectations for stakeholder engagement in this area, and makes it clear that this will be assessed in detail as part of stage 1 of the Business Plan Incentive.

## Net Zero

We welcome the fact that a key objective of RIO-ED2 is to deliver Net Zero at lowest cost to consumers, while maintaining high levels of reliability. The proposed adaptive approach to funding during the price control, including the Net Zero reopener should support this aim. We agree that

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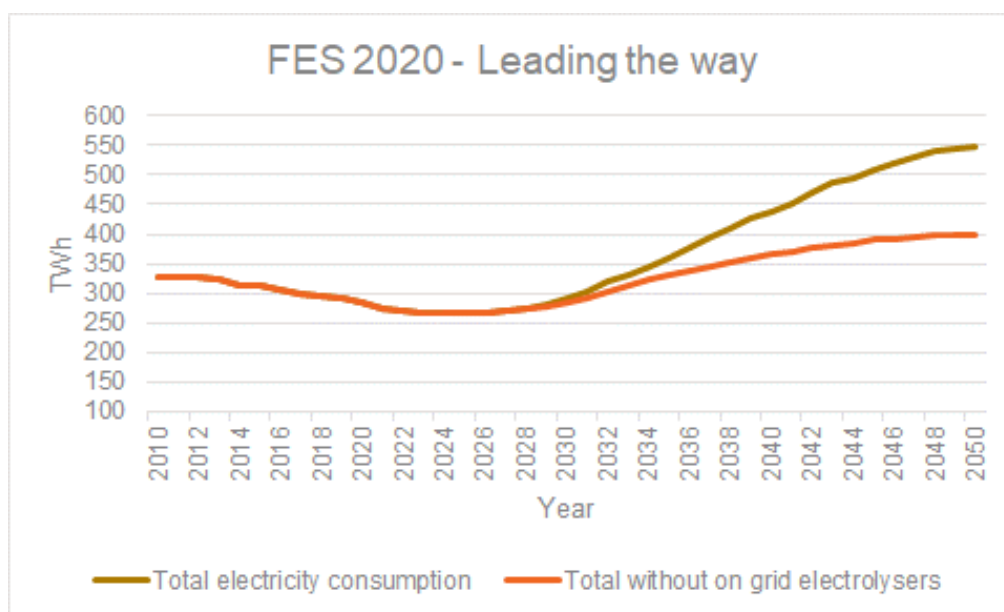
baseline funding for Net Zero should be based on a clear needs case, with the ability to flex expenditure when the scope, timing and cost of additional investments become clear.

We welcome the fact that a strategic approach to load related expenditure is proposed for RIIO-ED2, allowing asset interventions to be oversized as necessary in advance of need for expected future network reinforcement and increased utilisation. However, the calibration of this expenditure will depend on the chosen business plan scenario(s) and this is a critical area for RIIO-ED2 plan development and assessment.

#### Business plan scenarios

Ofgem's planning guidance asks DNOs to use Distribution Future Energy Scenarios (FES) and show how these will be used to create a 'central view' whole network forecast. A 'bottom-up' approach to deciding forecast demand and outputs for RIIO-ED2 will be valuable. Top-down forecasts of likely regional development of renewables and low-carbon technology uptake will inevitably not have the necessary granularity to give confidence in the forecast, and associated outputs and expenditure, but they will be an important cross-check.

A key area of scenarios where we think clarification between 'bottom-up' and 'top-down' forecasts will be important will be the identification of existing and future capacity 'headroom' and associated investment requirements. For example, the following chart shows the FES 'Leading the Way'<sup>1</sup> scenario which envisages a high electricity future.

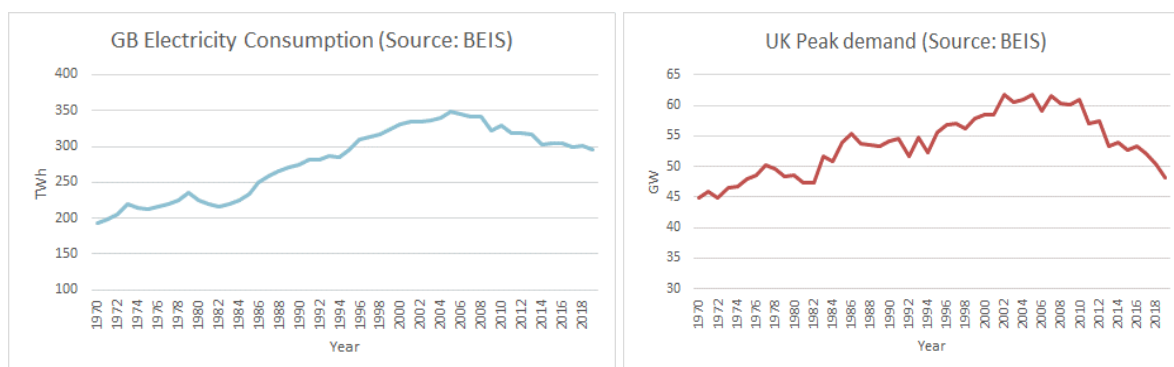


It illustrates that electricity consumption without on-grid electrolyzers (which are likely to be transmission connected and not impact the distribution networks) is expected to continue falling until the mid-2020s and then may not reach previous peak levels until the late 2030s. This ESO FES scenario is provided as an example but there will be other recognised national scenarios that may also need to be considered.

<sup>1</sup> <https://www.nationalgrideso.com/future-energy/future-energy-scenarios/fes-2020-documents>

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This future potential utilisation profile from the ESO FES may be compared with historic levels of network utilisation and peak demand as shown in the following charts<sup>2</sup>. These illustrate that historic peak levels of electricity consumption occurred around 2008 and have been falling steadily over recent years, and Covid may cause an increased decline.



Clearly, individual DNOs will have their own characteristics of actual and forecast cost drivers. The process for determining appropriate scenarios is critical for determining baseline expenditure, strategic expenditure, and making provision for additional Net Zero expenditure as necessary. Any expenditure for strategic 'headroom' included in baseline expenditure should be clearly justified against historic and future utilisation evidence.

In summary, we recognise that 'bottom up' plans bring the advantage of local knowledge but have the disadvantage that they may overstate requirements once taken in aggregate. We are concerned that the risk of over forecasting by the DNOs is high, leading to potential windfall gains. We suggest that the SSM and business plan process should derive scenarios for baseline totex plans that:

- use bottom up demand and capacity forecast information where it is more granular and robust
- reconcile bottom-up assumptions with credible national (top-down) assumptions – for example, that they do not aggregate to levels higher than set out in the ESO FES 2020 scenarios or other equivalent studies
- recognise that much additional investment will be undertaken by third parties, and that DSO interventions should reduce investment needs
- recognise declining demand profiles over the last 10 years, and that investment timing may be beyond the RIIO-2 period

We think that the Business Plan Incentive should be used to incentivise DNOs to prepare a well evidenced 'central view' plan that is consistent with 'bottom-up' and 'top-down' scenarios. Companies should be rewarded for providing well justified plans showing, for example, existing spare network capacity, and use of smart grid or non-network solutions to reduce incremental investment.

**Uncertainty mechanisms for Net Zero** – to protect consumers from unnecessary costs we think that larger investments, for example, those signalled by a local development plan, should be triggered by reopeners, with defined delivery outputs. Smaller investments may be more suited to the use of automatic volume drivers around a baseline, but these volume drivers must be robust. While volume

<sup>2</sup> <https://www.gov.uk/government/statistical-data-sets/historical-electricity-data>

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drivers should enable additional strategic ‘capacity headroom’ expenditure to be funded, measures should be in place so that companies do not receive windfall gains from over-forecasting this headroom. Baselines and uncertainty mechanisms should be well-justified and robust.

#### Providing clarity on access reform assumptions

In considering how baseline and strategic investment is to be sufficiently funded in RIIO-ED2 to make appropriate progress on net zero ‘*at least cost to customers*’, there are some important sequencing issues for Ofgem yet to address.

The draft RIIO-ED2 methodology recognises that there are some key interactions between Access SCR and RIIO-ED2. Access and charging reforms may change the scope of what is included in the sector price control. The change in scope because of reforms could reflect changes in the triggers for investment, the amount of investment expected, or in how investment costs are recovered. Ofgem is due to publish its ‘minded to’ consultation on access later this year.

These decisions will clarify the distribution network investment that will be funded via price control allowances and where the customer/DNO funding boundaries will lie. Detailed design of RIIO-ED2 baseline allowances and uncertainty mechanisms must be robust against both a ‘shallower’ or ‘shallow’ outcome. Clarity will also be needed on Ofgem expectations in driving DNO cost-efficiency in upstream reinforcement – in other words, how far will competition in connections (for DER, for load-related capex) continue to be viewed as a main driver of efficient upstream reinforcement costs? We think Ofgem should clarify the assumptions to be used for such investment scenarios as soon as possible, so that plans can be prepared accordingly.

#### Whole system, DSO and Innovation

DNOs and DSOs will play a key role in delivering whole system benefits. Analysis by Imperial College suggests that some £8bn per annum of savings<sup>3</sup> may be realised by 2030 through a more digitalised, dynamic, and whole system approach to power system planning and operation. As the energy system becomes more decentralised and decarbonised, DNOs and DSOs have an increasingly key role to play across the whole system of energy production, consumption, and network assets to realise these future carbon and economic benefits, while maintaining secure supplies.

We think there are considerable economic and decarbonisation benefits for consumers to be gained from a whole system approach to distribution networks. These benefits may be realised through :

- making better use of transmission and distribution networks by improved utilisation of physical asset capabilities both across and within these networks
- substituting the need for network investment with cheaper non-network solutions, such as flexible Distributed Energy Resources (DER)
- enabling access by Distributed Energy Resources to participate in electricity wholesale and balancing markets.

The RIIO-ED2 price control should put the mechanisms and incentives in place to ensure these benefits can be identified and delivered. It is welcome that the methodology draws out further development of DSOs and their roles in delivering whole system benefits. But we have concerns that

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<sup>3</sup> Pöyry Consulting and Imperial College London “Roadmap for flexibility services to 2030”, Report to the CCC, 2017, <https://www.theccc.org.uk/publication/roadmap-for-flexibility-services-to-2030-poyry-and-imperial-college-london/>

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a lack of co-ordination between the ESO, DSOs and other key stakeholders, allied with deficiencies in asset and flexibility market information, and potential DNO conflicts of interests may present barriers to change. It is important that there is an incentive for companies to innovate and deliver solutions – for example, non-network solutions, that result in additional benefits for consumers.

We think barriers risk undermining the adaptive and agile approach that is needed for the energy transition. It presents a significant risk to the realisation of whole system benefits. To achieve whole system benefits, Ofgem will need to establish appropriate industry governance and resources, its own internal capabilities, and perform a whole system leadership role in an agile manner.

We note that an adaptive regulatory and incentive regime has been established for the ESO through its 2-year plan reviews, and we think a similar approach could be useful to incentivise and regulate DSO performance.

#### **Innovation**

We welcome the proposal that the Strategic Innovation fund will be available for the RIO-ED2 price control. We think this should be particularly targeted to whole system initiatives, enabling new players and ideas to bring innovation and benefits to the sector. Ofgem should consider how beneficial ideas from non-network companies might gain effective access to the funding.

We agree that companies should not be funded for business as usual innovation used for their internal business improvement.

#### **Outputs and incentives**

##### **Meeting the needs of consumers and network users**

We strongly support the approach that service improvements achieved during RIO-1 should now be expected as business as usual in RIO-2. In line with that, and considering the relatively good service standards likely to be achieved by the end of RIO-1, we support the proposal only to offer additional rewards for further significant improvements, but for penalties to kick in quickly if standards drop.

We welcome Ofgem's introduction of a new form of 'strategy delivery' incentive throughout this methodology. The setting out of clear baseline standards in a number of areas, including how DNOs handle consumer vulnerability, is particularly welcome.

More broadly on vulnerability, we welcome the package of measures set out in this methodology. This is an improvement on those used in ED1, and on the approach set out for gas distribution for RIO-2. However, we are concerned that, given the uncertainty that remains around the Consumer Value Proposition mechanism in particular, it may still not be effective in stimulating sufficiently ambitious plans from companies.

As a general comment, we also suggest that Ofgem could deliver benefits for customers (and avoid potential detriment) earlier in the price control cycle by investigating the different and changing experiences of customers while developing its methodology, rather than waiting for these insights to appear through companies' reporting over the course of the period.

##### **Network reliability and resilience**

We welcome the approach that Ofgem has taken to ensure that network reliability continues to be incentivised and agree with continuing most of the reliability incentives regimes from RIO-ED1.

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For resilience, the bulk of the RIO-ED2 expenditure is likely to be required to maintain robust asset health and it will be important that this is spent effectively. We welcome the application of the Network Asset Risk Metric (NARM) approach to set targets and assess whether asset health outputs are delivered. However, we are concerned that the NARM data and methodology is relatively immature and agree that a wider toolkit is required to justify investment decisions. We welcome the steps that are being planned during RIO-ED2 to improve the future quality of NARMs data and ensure better alignment and consistency across the sector.

#### Delivering an environmentally sustainable network

We have welcomed the 'strategy delivery' incentive approach in various parts of the draft methodology. We would also urge Ofgem to introduce an equivalent strategy incentive to drive environmental progress, in particular for decarbonisation and net zero. This would be significantly more effective than the weak reputational incentives proposed which we do not think are sufficient to drive ambition and improvements in this vital area. This is particularly the case for carbon emissions associated with losses. This is a complex area but, if these emissions are to be effectively monitored and managed, we consider that better incentives are required. A financial incentive (set at a proportionate level) would also send a stronger signal about the value of decarbonisation and net zero to current and future consumers.

On SF6 leakage, having developed a financial incentive for electricity transmission, we would expect the same incentive to be applied to distribution. We recognise that leakage is much greater in transmission, but this remains a highly potent greenhouse gas with a global warming potential some 23,000 times that of CO2. The value of savings per kg of SF6 from either sector should be the same provided a consistent value for the cost of carbon is used.

#### Cost assessment

We welcome Ofgem's approach to cost assessment for RIO-ED2 which aims to ensure a high level of service quality and to enable decarbonisation, whilst ensuring costs are efficient. The price control needs to enable the energy transition while continuing to seek efficiency savings and limiting the risk and cost to consumers of investment in stranded assets. Ofgem's cost assessment should take account of the following downward cost drivers:

- decreasing demand/network utilisation, due to increased energy efficiency, permanent Covid-related demand reductions, and increases in distributed energy resources
- improvements in network capability, resulting from non-network flexible solutions to manage supply and demand, and benefits from smart systems and innovation.

And also upward cost drivers, including:

- increased network demand from heat and transport; connection of new distributed energy resources; policy decisions for anticipatory capacity investment
- investment in smart systems/active system management to enable future benefits.

We think that challenging efficiency targets should be set. In particular, we suggest Ofgem should assess the outturn of the smart system benefits identified by DNOs in RIO-ED1. Future savings may be expected and should be captured in efficiency targets.

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As set out in our comments above on Net Zero, we are keen to see that Ofgem's approach to setting baseline expenditure allowances uses a robust 'central view' forecast that quantifies the impact of these upward and downward cost drivers. We think that baseline expenditure and outputs for each plan should use common utilisation parameters – for example, numbers of electric vehicles (EVs), low carbon technologies (LCTs) etc. The individual DNO forecasts should be aggregated and reconciled with the 'central view' forecast.

Given the uncertainty associated with these cost variables, we agree that Ofgem should use a broad cost assessment toolkit for RIO-ED2 comprising econometric benchmarking, activity level analysis, individual project review, expert review and cost benefit analysis.

## Competition

We welcome that the sector methodology seeks to introduce new forms of competition that could facilitate new entrants, drive innovation, and introduce new solutions and technologies.

With regard to competition for flexibility solutions, while enabling flexibility between network and non-network solutions is welcome, we would like to see transparency in how decisions are made to choose between asset and non-asset solutions, and whether the expected benefits were realised. Suitable reporting mechanisms should be established so that the benefits can be assessed over time and DNO performance compared.

For competitions for new investments, given that there is already an active market for competition in connections, we suggest that Ofgem expands the scope of its proposals to increase competition through early or late competitions. Regular reporting mechanisms should be established to show the activity in the connection and investment markets, allowing DNO performance to be compared.

## Uncertainty mechanisms

We agree that the companies should have uncertainty mechanisms to mitigate expenditures resulting from exogenous events and risks that are outside their control, but not for expenditures where the risks lie within their control. Ofgem's proposals appear to strike the right balance.

The RIO-ED2 price control period faces uncertainty about the energy transition and future distribution network utilisation. Future expenditures and outputs will be impacted by:

- reduced network utilisation due to expected energy efficiencies, time shifting of demand from peak times, and increased output from distributed energy resources
- increased network utilisation due to forecast increases in electric vehicles and electric heating, and the policy decision to include incremental or anticipatory expenditure.
- the current headroom on the networks given the decrease in electricity demand over the last 10 years or so.

Because of these uncertainties, we are concerned that RIO-ED2 baseline expenditure allowances will be either higher or lower than they need to be, and agree that uncertainty mechanisms are necessary to adjust allowances accordingly. We welcome the Net Zero reopener and the Co-ordinated adjustment mechanism (CAM) and the flexibility they should provide. We suggest that the CAM could operate in advance of a Net Zero reopener. In other words, the first actions in the price control reopener process could be to true up under/overspend between DNOs before adding additional expenditure through a Net Zero reopener.



## Business plan incentives

We think that the structure of the Business Plan Incentive (BPI) is an improvement on the version used to incentivise RIO-2 plans in other sectors. In particular, we welcome the inclusion of an assessment of the various new strategies against Ofgem's proposed baseline standards as part of Stage 1 of the BPI. The opportunity for companies to receive a Consumer Value Proposition reward if their strategies reveal higher standards that can be applied across the sector has merit. However, we foresee that these standards – which must be higher than 'business as usual' rather than only baseline standards - will remain difficult to identify in practice.

We would also strongly urge Ofgem to include clarity that, in stage 1 of the assessment, a materially incomplete first draft submitted to the Challenge Group is not acceptable and could be subject to a penalty. Without complete plans (at both draft and final stage), the Challenge Group cannot carry out the role that Ofgem has asked of it as fully or as well as is required by our Terms of Reference.

We welcome the stage 3 and 4 incentives which should motivate the companies to provide well justified and efficient cost forecasts. We suggest that Ofgem may wish to consider strengthening this incentive regime – for example, by strengthening the relative incentive value of stages 1 and 2, to ensure that high quality baseline expenditure plans are provided.

## Finance

The requirement to achieve Net Zero implies a degree of uncertainty for all the network companies and means that, in the next price control period, a higher proportion of their totex than hitherto will be subject to uncertainty mechanisms. The uncertainties relating to Net Zero will potentially be exacerbated over that period by economic uncertainties relating to both Brexit and the Covid-19 pandemic. However, the regulatory settlement proposed for gas distribution and transmission and that set out in the SSM Consultation for electricity distribution (including the proposed RAM arrangements) provide all the network companies with a very high degree of protection. Overall, we consider that a combination of the regulatory framework and the specific arrangements proposed means the risk profile of the network companies for RIO-2 is lower than it was in RIO-1.

The DNOs are clearly exposed to demand risk and the need to comply with Ofgem's requirement for strategic investment to provide the necessary Net Zero-related headroom, but we consider this needs to be seen in the context that:

- a) connections are already open to competition (thus reducing the expenditure risk) and
- b) any requirement for ED expenditure is likely to take the form of a number of relatively small projects rather than a smaller number of – potentially riskier – larger ones.

Overall, therefore, there is in our view nothing to indicate that, in the light of the requirements on the DNOs and the regulatory protection which they are afforded, the residual systematic risk is higher for ED than for the other network companies and indeed, that a good case can be made that the risk profile is lower for ED. We encourage Ofgem to keep this in mind when considering cost of capital allowances for ED: in our view, the proposals in the SSM Consultation both in relation to the cost of debt allowances (with their very substantial allowance for issuance costs, payable on all debt) and the cost of equity allowance with its ex post review of the 'wedge' are unnecessarily generous.

We are keen that the SSM should encourage a more nuanced approach to financeability than was evidenced in the gas distribution and transmission business plans, including a focus on a range of ratios

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and the use of measures which are at low cost to consumers such as small adjustments to depreciation periods and capitalisation rates to improve ratios. We are also keen that companies should be required to undertake a much more detailed consumer consultation exercise in relation to financeability issues (with a particular – but not exclusive – focus on those which have an intergenerational impact) than has been evidenced in RIO-2 sectors so far. We persist in the view that, with well-structured questioning and an appropriately selected group of consumers, this is a feasible proposition and one that, going forward, needs to be firmly embedded in the methodology of business plan development.

## Appendix – RIO-ED1 Sector Specific Methodology Consultation

### Overview document

#### Interlinkages and CMA Appeals in RIO-2

We have no comments to make in this area.

*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 RIO-2 in the event of a successful appeal to the CMA that had material knock on consequences for the price control settlement*

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

#### Net Zero and innovation

We agree that a strategic approach to load related expenditure is an important requirement for RIO-ED2, allowing asset interventions to be oversized as necessary in advance of need for expected future network reinforcement and increased utilisation. The calibration of this expenditure will depend on the chosen scenario(s) and we think this is a critical area for RIO-ED2 plan development and assessment.

In considering how strategic investment is to be sufficiently funded in ED2 to make appropriate progress on Net Zero ‘at least cost to customers’, there is some important sequencing for Ofgem yet to address.

**Distribution access and charging** - First, reform of distribution access charges is a welcome and important step in facilitating connection of new distributed generators and new LCTs to make progress on Net Zero delivery. However, some major outstanding questions remain, including on where the boundary for recovery of the costs of upstream distribution network reinforcement will be drawn in the future – in other words, whether connection charges will become ‘shallower’ or ‘shallow’. This matters because it will re-define what proportion of upstream network reinforcement costs will be borne by an individual connection customer (or group of customers) and what proportion will be borne by the distribution networks with those costs socialised via distribution charges across all customers.

The draft ED2 methodology recognises that ‘there are some key interactions between Access SCR and ED2. Access and charging reforms may change the scope of what is included in the sector price control. The change in scope as a result of reforms could reflect changes in the triggers for investment, the amount of investment expected, or in how investment costs are recovered’ (8.4 & table 13. Potential impact of Access SCR on RIO-ED2. p72). Ofgem is due to publish its ‘minded to’ consultation on access later this year.

One major area where Ofgem’s final decisions on access reform will significantly matter is in the total sums likely to be funded in the ED2 period – either for baseline or for strategic investment via uncertainty mechanisms.

For example, how is one to know with any degree of certainty what level of distribution network investment must be funded via price control allowances without an understanding of where the

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boundary for funding upstream network reinforcement will sit (shallower or shallow). Detailed design of ED2 uncertainty mechanisms must also be robust against both a 'shallower' or 'shallow' outcome; and clarity will also be needed on Ofgem expectations in driving DNO cost-efficiency in upstream reinforcement – i.e. how far will competition in connections (for DER, for load-related capex) continue to be viewed as a main driver of efficient upstream reinforcement costs.

**Adaptive regulation** - Second, we support the principle of adaptive regulation for NZet ero given future uncertainty and likely variability on the uptake, pace and location of connections for new distributed generation and low-carbon technologies on the distribution networks.

However, it also seems important for the companies to have some line-of-sight in the final ED2 SSM on the likely split between investment which might reasonably expect to sit within base-line revenues and the proportion of investment subject to uncertainty mechanisms triggered only later in the price control period (either within or out-with baseline).

In considering this split, Ofgem needs to acknowledge that the nature of investment at distribution voltages is fundamentally different from transmission – with very many smaller individual projects. The relative initial split of revenues allocated to baseline allowances therefore may arguably matter more for distribution than transmission. To make timely progress in ED2 towards Net Zero, Ofgem needs to recognise the importance of at least some investment 'headroom' for DNOs to be sufficiently agile in facilitating and delivering many new connections (including alternatives to new network investment). DNOs must be in a position to respond to the well-evidenced Net Zero needs of others in a timely way.

If all future connections-related investment ends up sitting outside baseline allowances – and/or is enabled only via uncertainty mechanisms for later agreement (whether that be automatic/non-automatic) - then there is a risk that the DNOs could needlessly slow the legitimate Net Zero ambitions and targets of others. Alternatively, DNOs may be at risk of developing and operating their networks in a needlessly inefficient or piecemeal way.

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

It is important to retain some flexibility with adaptive regulation to re-set ED2 allowances to align/ re-align RIIO-2 price control outputs with major changes on Net Zero, be that legislation or policy. This is especially so for any major clarification of GB heat policy.

We agree that the Net Zero re-opener should be a 'last resort' mechanism - for use where other uncertainty mechanisms or innovation funds are inappropriate and where policy or legislation was largely unclear at the point of final business plan determinations. For this reason, we favour the wide scope as outlined by Ofgem (e.g. only for material changes in government policy, major technological changes, or whole system developments). We also agree that the Net Zero reopener should be triggered only by Ofgem to avoid 'gaming' of re-opener 'routes' and also to have a high materiality threshold (for example, > 1% of base revenue).

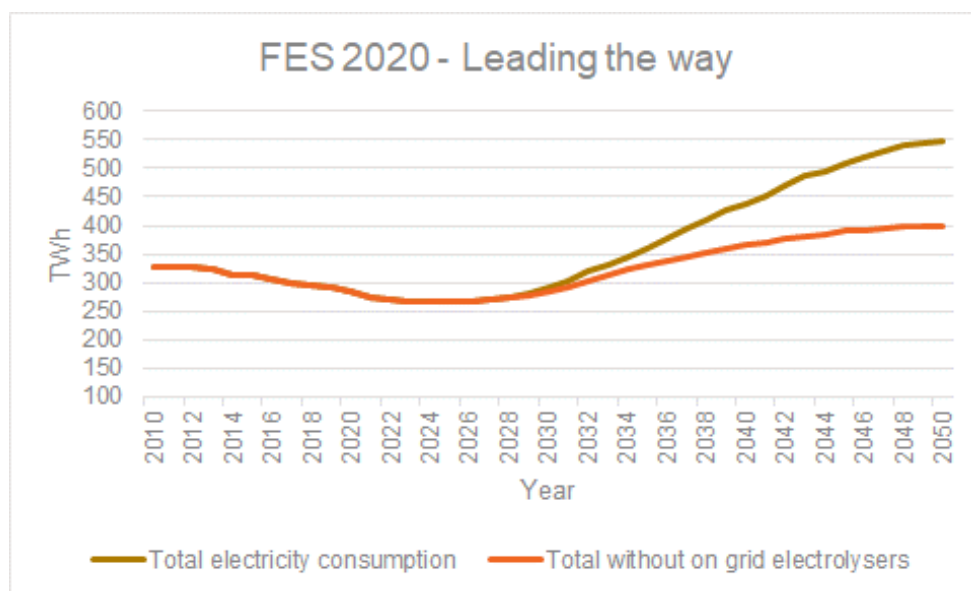
*OVQ4: In what circumstances, would a centralised approach to setting forecasted outputs be appropriate? What form should this take?*

Load related expenditure during RIIO-1 accounts for around 10% of total expenditure (some 40% below allowances). It was provided to invest in new capacity where demand was expected to increase beyond existing network capacity, but uptake has been slower than expected. Annual

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electricity peak and energy demand has fallen consistently since 2008, and this decline is expected to continue until new demands from EVs and heat are anticipated in the mid-2020s.

This is illustrated by the high electric 'Leading the Way' scenario from the 2020 FES. It illustrates that electricity consumption without on-grid electrolyzers (which are likely to be transmission connected and not impact the distribution networks) may not reach previous peak levels until the late 2030s.



While such central scenarios are informative, they are unlikely to be uniformly represented across DNOs with each likely to experience different growth (or contraction) of load related expenditure requirements.

In practice, a solely centralised approach to deciding forecast outputs for ED2 seems inappropriate. Top-down forecasts of likely regional development of renewables and LCT uptake will inevitably be relatively poorly informed. Nevertheless, indication of top-down expectation on some key outputs for the ED2 period will offer basic benchmarks – necessary to the companies, their stakeholders including the CEGs, Ofgem and the Challenge Group – by which to question and, in the end, to understand and judge outliers in companies' individual decentralised forecast outputs. As a minimum, indication from Ofgem of sources for top-down 'central view' forecasts would be helpful. These should include:

- HMT/OBR central forecasts on post-Covid annual economic growth to 2030 (national, regional);
- Department for Transport and manufacturer forecasts on potential pace of EV uptake; and
- rate of expected heat electrification nationally and regionally.

Forecasts, scenarios, the distribution FES and local area energy plans produced by local authorities – informed by thorough and systematic stakeholder engagement - each have a major role in informing and demonstrating the underlying evidence-base and realism of company ED2 business plans. These are important areas to get right – both in combination and in terms of sequencing, including for judging outcomes on the BPI/CVP incentives.

Critically too, the outputs of these forecasting/scenarios exercises will also inform Ofgem decisions on how far investment allowances are to be treated from the outset as baseline (i.e. where

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‘certainty’ is robustly evidenced) and how far allowances should be subject to uncertainty mechanisms (because more ‘uncertain’) – be that within or outwith baseline revenues.

Getting forecasts ‘right’ is an impossible task. So, very importantly, if as proposed above, price control deliverables within baseline are designed to have well-designed and clearly quantified volume drivers (e.g. £x/MW or £y/MWh) - with appropriate levels of periodic audit and reconciliation - then the materiality of getting forecasts and scenarios ‘right’ – in order to provide assurances on Net Zero ‘at least cost to consumers’ – potentially reduces significantly.

In its four models (A-D) for addressing uncertainty, Ofgem differentiates between a centralised approach to setting forecast outputs - with (A) more certain or (B) less certain - against a decentralised approach to determining forecast outputs - with more certainty (C) or less certainty (D). In our view, this thinking is needlessly binary as between ‘central’ and ‘decentralised’. There is a clear place both for a central view and a DNO-level decentralised view – and where timely engagement, iteration and transparency must inform both.

We would like to see plans that are developed using robust decentralised information, but which are also credible and consistent against national assumptions and scenarios, once aggregated.

*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 set out above, a centralised scenario approach provides the opportunity to assess whether the overall assumptions used in the decentralised plans are credible and consistent. Similarly, it allows the proposed outputs in the individual and aggregated plans to be assessed.

In this context, a centralised approach may have high certainty if it:

- confirms with the aggregated assumptions and outputs of the decentralised plans
- is based on centrally provided evidence where there is higher confidence than that provided by the decentralised plans. For example, decentralised plans may tend to over or under-estimate outputs, and not take account of the aggregation impacts.

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

A decentralised approach should provide better information and give greater confidence, but it is liable to information asymmetry by the DNO and incentives for them to bid higher than necessary. This should be addressed by ensuring that the information provided is as robust as possible.

Each DNO must produce a D-FES (tied into the FES) and a Long-term Development Plan. They must also demonstrate a strong process on engagement to inform their own forecast outputs. Given the fundamental switch to decentralised energy and LCTs since ED1, it is self-evident that decentralised approaches to determining forecast outputs must become a cornerstone of the ED2 methodology. At the same time, reliance on largely decentralised forecasts of outputs to determine ED2 allowed revenues brings new challenges for the companies, stakeholders, Ofgem and others to establish well-assured ‘central view’ forecasts for business plans.

New common frameworks, processes and checks need to be developed by DNOs - and agreed with Ofgem - to satisfactorily demonstrate the robustness of the underlying evidence put forward in individual ED2 business plans. Demonstration of these processes and frameworks must under-write Ofgem and stakeholder confidence in DNO forecasts on volumes and expected timing of new

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renewable and LCT connections across their networks. The outcome of the BPI should link clearly to the timeliness and quality of the decentralised forecast outputs, including:

- demonstration of a strong and systematic *process* across their full geography to engage on, to inform and to test DER & LCT forecast outputs for the ED2 period in line with Net Zero expectations. This to include underlying growth assumptions for the pandemic recovery.
- adoption of a framework and process common across all DNOs - as suggested by the Scottish Government in Ofgem's ED2 Over-Archiving Working Group – to enable devolved, regional, or local authorities with active Net Zero commitments and/or who expect to go faster than 2050 – to demonstrate to the satisfaction of the DNO that their ambitions are potentially funded, achievable and robust, including realistic consideration of potential network options within ED2 time-frames.
- information and support provided for connectees to make economic choices on DER & LCT connections through heat-maps and similar initiatives (i.e. to tie into the Large Connections Strategy Delivery incentive)
- clear demonstration of how forecast outputs for DERs and LCTs are fed into ED2 business plan proposals for non-network alternatives and/or for future optionality.

*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?*

See our answer to OVQ6 above.

*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 draft Local Area Energy Plan best practice guidance from CSE and ESC is a helpful document. In the first instance, this aims to inform local authorities on how to develop robust energy plans to support them in their approaches to others, including to DNOs, Ofgem or government.

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

We have described above that we think Ofgem should support a moderately good future line-of-sight for the companies on baseline allowances. As such, Ofgem should give more thought to its proposals on uncertainty mechanisms<sup>4</sup>. We think it is important that consumers should benefit from strategic investments both in terms of enabling Net Zero, but also in seeing the additional expenditure on assets delivered during the period.

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

Yes, we think that companies should not be funded for innovation that they are able to undertake themselves as part of their ongoing business improvement activities. Companies should be passing the benefits of prior innovation funding through to customers through the totex incentive

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<sup>4</sup> Appendix 3. A3.2 p 82. Uncertainty Mechanisms. Presented as either (1) a PCD with funding triggers based on a regional plan (eg award of government funding, phase out of gas boilers) or (2) Volume Drivers – LCT volume driver, or, Capacity volume driver.

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mechanism. We agree that innovation should focus on the energy transition and enable increased engagement and new ideas from third parties.

We welcome the proposal that the Challenge Group will be able to challenge the level of ambition in the companies' innovation strategies.

*OVQ11: Do you agree with our proposed methodology in relation to the RIO-2 Strategic Innovation Fund?*

Yes, we welcome the approach proposed in the Strategic Innovation Fund, and that this should enable larger, more impactful innovation investments to be made in support of the energy transition. Again, we welcome that the intent is to enable the inclusion of third-party innovators, bringing new ideas and experience.

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

Yes, we think this is an appropriate approach. We welcome the fact that innovation stimulus is also being focused on addressing consumer vulnerability.

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

Given the potential benefits from a 'whole system' approach, we suggest that this framework should consider projects that bring benefits across the whole energy system and not just in the network company sectors.

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

We think that quality assurance should particularly include how well the companies communicate the outcome of innovation projects through industry or public fora.

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

Yes, we agree with this approach. We agree that companies should be taking responsibility for their own BAU innovation funding.

### **Modernising energy data**

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

We think that digitalisation of the sector is critical for realising the energy transition, and a licence obligation to drive progress is welcome. However, the capabilities and pace of change is likely to vary between companies, which may lead to barriers to change.

We suggest that this licence obligation may need to be accompanied by an effective monitoring and compliance regime so that performance can be tracked. The RIO-2 business planning process gives a good opportunity for companies to demonstrate their current capabilities and commitments for the future, and for this performance then to be monitored.

We suggest that there is a critical need for communication of energy planning and operational data between distribution companies and the ESO such that significant whole system benefits may be realised. There is a conflict of interest for DNOs, and the RIO-ED2 price control will need to ensure



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that any such barriers are removed. We think DNO plans should include steps to ensure that barriers are addressed and that whole system benefits are enabled.

#### DSO transition

*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?*

As DNO networks become increasingly active due to increases in distributed energy resources including active demand, it is critical that DSO functions develop accordingly. It will be important to ensure that DSOs are not limited in taking the appropriate actions in pursuit of the optimum economic, technical and Net Zero solutions.

While there may be barriers to this optimal performance due to conflicts of interests from their parent companies, there are also likely to be barriers resulting from ineffective whole system co-ordination, information unavailability, lack of interoperability, and cumbersome existing industry rules and processes. We suggest that priority should be given to identifying and addressing these barriers and ensuring that the associated DSO capabilities are built.

We agree that the right governance framework should be in place for DSOs so that outcomes, capabilities and costs/benefits are clearly identified. We think that the need for separation of DSOs should remain under consideration, but decisions should wait until there is a clearer view about the benefits and options for moving to a new form of distributed energy control and operation. It may, for example, be beneficial for DSOs to realise whole system benefits in their current geographic territories, but this may fail to realise benefits from across DNO geographical territories.

*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 to adopt these revealed standards?*

DSOs have a critical role to play in the energy transition and in helping to realise whole system benefits. We support the use of the Business Plan Incentive to incentivise DNOs to identify ambitious targets for benefits and roadmaps for delivery.

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

Yes, we think it is essential that companies quantify their proposed performance metrics and targets. These should include economic and technical performance benefits from enhanced system operation and planning (both in the short and long term).

*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 welcome that an ex post ODI is proposed, and this could potentially operate in a similar way to the performance regime for the ESO price control. It could take account of a range of factors, including:

- real-time/short-term operational performance

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- longer-term operation and planning, including procurement of flexibility solutions
- co-ordination - it could include some common co-ordinated outputs with the ESO to ensure effective whole system co-ordination.
- delivery of enabling actions – for example, new IT platforms, market information availability, market access to third parties etc.

The incentive regime should be sufficiently strong so as to incentivise performance effectively. Challenging targets should be set so as not to reward business as usual performance.

*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?*

This area is changing rapidly, so we think it is important that the performance assessment is sufficiently frequent so that good or poor performance signals are provided at an early stage. Having regular reviews should also give the companies confidence about the process and how its views may be presented and assessed.

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

We suggest that the values for the DSO ODI should be aligned as far as possible with the savings that they are able to realise. For example, the DSO may help deliver savings to network costs through mitigating investment. In this case, it would appear appropriate that the incentive should be represented as a percentage of totex, given that the DSO's actions would have reduced expenditure.

We think it is important that the DSO is incentivised to seek whole system savings and that business as usual is not rewarded.

*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 RIO-ED2? Do you think amendments or additional baseline expectations are required?*

The list appears to cover the key DSO functions. However, we think that DSOs should be given clearer responsibilities for the achievement of Net Zero and whole system strategic objectives. The focus on flexibility services appears quite narrow, and co-ordination requirements with the ESO on flexibility and whole system aspects should be enhanced.

Overall, we are concerned that the baseline expectations are very narrow and operational and do not address the DSO role in achieving the strategic objectives of the energy transition.

### A whole system approach

We think there are considerable economic and decarbonisation benefits for consumers to be gained from a whole system approach to distribution networks. These benefits may be realised through:

- making better use of transmission and distribution networks by improved utilisation of physical asset capabilities both across and within these networks
- substituting the need for network investment with cheaper non-network solutions, such as flexible Distributed Energy Resources (DER)

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- enabling access by Distributed Energy Resources to participate in electricity wholesale and balancing markets

The RIO-2 price control should put the mechanisms and incentives in place to ensure these benefits can be delivered. In our view, these should provide for:

- **Enhanced utilisation of DNO networks** - DSOs should pursue initiatives to enhance the utilisation of DNO assets. They should have the capability and knowledge to fully exploit the physical capabilities of the DNO assets. The development of digitalised, more intelligent, network monitoring and control should seek to deliver the required resilience at lower cost. DSOs should have full access to DNO network information. This enhanced role may require additional investment in ICT systems and associated capabilities, which should be justified through cost benefit assessments.
- **Enabling non-network solutions** – alongside the enhanced utilisation of their networks, DSOs should seek all opportunities to take advantage of non-network solutions as an alternative to investment. This should fully consider the range of alternative options available, and the benefits of competitive procurement.
- **Accessible markets** – DSO/DNOs have a key role to play in making information available for flexibility services, non-network solutions, and access for DER and new demand connections to their network. But they may be reluctant because it conflicts with their network business interests. DSOs must make this information readily available, publishing timely, accessible market information and ensuring tender processes are open and fair.
- **Effective co-ordination with ESO** – the realisation of whole system benefits will need effective DSO/ESO co-ordination. Clear responsibilities, plans, and incentives should be established to ensure that information flows and initiatives are geared to realise whole system benefits in both operational and investment timescales.

**Ofgem's leadership role** – while the emergence of DSOs should lead to many opportunities for whole system benefits to be realised, there are risks arising from potential lack of co-ordination between DSOs and with the ESO, with regulatory frameworks and market structures, and arising from DNO conflicts of interest. Roles and responsibilities of all parties need to be clear. It will be important for Ofgem to maintain oversight of this process and ensure that any barriers are addressed.

*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?*

As set out in our earlier comments, we see the main barrier being one of co-ordination of DSOs with other industry participants and especially the ESO. There will be barriers arising from a range of factors including, governance, conflicts of interest, communication channels, existing rules and regulations, industry processes etc. All of these present barriers to agility and to the ability to enable whole energy system benefits.

We have suggested that this co-ordination to realise whole system solutions should be specifically included in the proposed ex post ODI.

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

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DNOs have a critical role to play in the realisation of whole system benefits that will contribute to lower costs, secure supplies, and decarbonisation. In particular, they have key roles to play in:

- allowing access by distributed energy resources to networks and markets
- enabling non-network solutions to network constraints
- co-ordination with others to enable whole system solutions.

We think that plans and initiatives to enable whole energy system development (and gaining the associated benefits) should form an important part of DNO plan assessment and the Business Plan Incentive.

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

Yes, we think the innovation stimulus should place a high priority on initiatives to realise whole system benefits. This type of cross cutting activity may not be pursued without this stimulus. Again, we would suggest that the involvement of third-party innovators, bringing new ideas, is actively pursued in this process.

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

Yes, we welcome the proposals for the Co-ordinated Adjustment Mechanism (CAM) re-opener. We think this should help deliver the most efficient solution to a system need and make the price controls more adaptable. We would like to see this deliver the best network or non-network solution so that whole system benefits may be realised.

We think that the CAM should operate ahead of the Net Zero reopener, in that the option to reallocate allowances for investment solutions driven by Net Zero should first seek to ensure that any likely reduction in existing allowances be re-allocated before new allowances are provided.

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

Yes, we think these should be appropriate. The application and decision process should be clearly defined and consider both network and non-network solutions in the cost benefit assessments.

*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?*

Given the CAM will already be applicable for ET and GD from 2021, we think it should also be available for use in the ED sector so that whole system benefits may be identified as early as possible. In these circumstances, the application windows may need to be co-ordinated across the different sectors.

#### [Access SCR](#)

As set out earlier in our response, our main concern about the SCR is the sequencing that will take place with the submission of DNO plans and RIO-2 decisions. There is a risk that the implications of a change to access and charging cannot be confidently assessed in time for the finalisation of business plans. While the Ofgem methodology seeks to address this by requiring certain assumptions to be applied, this may still result in lower confidence forecasts being submitted.

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We have not provided detailed comments on Ofgem's questions but would suggest that the impacts of the SCR upon plan baselines are discussed with CEGs and the Challenge Group well in advance of the draft and final plan submissions.

*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?*

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

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

*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?*

### COVID-19

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

One of the impacts of Covid-19 may be a permanent reduction in electricity demand due to the economic downturn, changes in working practices and in consumer behaviour. These reductions may potentially delay the need for future investment in electricity networks e.g. by creating additional capacity headroom.

If Ofgem determines this is the case, then mechanisms should be introduced to ensure that expenditure allowances take this underlying change into account.

## 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 proposal to set lower and upper limits on the value of bespoke ODIs at 0.25% and 1% of base revenue seems a reasonable way to ensure that sufficiently material proposals are brought forward, but also that sufficient funding is available to reward the risk involved in newer outputs. We suggest that Ofgem also uses this methodology to resolve wider issues in relation to bespoke ODIs, having learned the lessons of the application of these in gas distribution and the other network sectors. In particular, it should make clearer what level of evidence is sufficient for Ofgem to judge a bespoke proposal acceptable. We would also suggest that Ofgem ensures that the application of the minimum value approach is sufficiently flexible to allow for a package of bespoke measures that, together, have the potential to deliver significant benefits to consumers or customers, but which may include individual elements with costs lower than the 0.25% of base revenue limit.

*OUTQ2: Do you agree with our proposal for a minimum value for bespoke PCDs?*

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A minimum value of £15m for bespoke PCDs seems reasonable as a way to ensure that proposals are material, and reasonably consistent in scale between companies.

#### Meet the needs of consumers and network users: Customer satisfaction

*OUTQ3: Do you agree with the proposed scope and associated customer category weightings for the satisfaction survey?*

We agree that Ofgem should require companies to report separately on satisfaction scores for customers on the Priority Services Register (PSR) who experience a supply interruption, and customers who are installing or operating low carbon technologies (LCTs) connected to the distribution network. As part of the companies' review of the survey, Ofgem should ensure that the survey methodology is appropriate to capture the experiences of the full range of customers on the PSR. There is also a risk that this new survey focus could disincentivise companies from registering as many eligible people as possible on the PSR. So, it is important that the requirements around PSR registers in the new baseline standards are effective at mitigating this risk. We have suggested that Ofgem includes an explicit expectation in these standards that the numbers of customers registered on the PSR will increase to appropriate levels during RIO-ED2.

We would also encourage Ofgem to review survey results for these customer segments as early as possible in ED2. If results suggest that the experience of these groups of customers is significantly worse, then Ofgem should consider adjusting the weight given to different audience groups in the incentive to ensure that companies quickly identify how better to meet their needs. In the survey methodology review, we would also suggest that Ofgem ensures that questions are included that allow it and the companies to understand the key drivers of higher and lower levels of satisfaction. In RIO-3, this would allow Ofgem to consider the merits of further focussing this incentive on particular problem areas for customers, which may be hidden within overall scores which are good. We also support the proposal to extend the existing connections survey to include some small to medium connections customers who are not currently included.

As a general comment, we think that Ofgem could deliver benefits for customers (and avoid potential detriment) earlier in the price control cycle if it investigated the different and changing experiences of customers while developing its methodology, rather than waiting for these insights to appear through companies' reporting in period.

*OUTQ4: Do you agree with our proposed approach to target setting and calculating rewards and penalties in RIO-ED2?*

We support Ofgem's preferred method of using 'static, relative' targets, and to offer rewards only for performance in the upper quartile of the final range, and penalties for below average scores. Penalties that kick in quickly are particularly important to mitigate the risk that current good service standards may fall back in RIO-ED2. We support retaining the 1% incentive strength as this should still offer a meaningful reward to encourage companies to strive for upper-quartile levels of performance, as well as a sufficiently strong disincentive to let performance standards drop.

*OUTQ5: Do you agree with our proposed approach to setting complaints metric targets in RIO-ED2?*

We agree with the proposal to retain a penalty-only financial incentive for complaints, and to maintain the strength at 0.5% of revenue. The weighting of the incentive looks reasonable, in particular the 50% weighting on 'repeat complaints', combined with tougher targets. Complaints should be handled in such a way that resolves a customer's issue efficiently and empathetically –

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but, equally importantly, they should be used as a way to diagnose (through root cause analysis) wider product or service shortcomings. In that context, we are surprised by the comment that DNOs' 'repeat complaints are at almost zero'. This would suggest that their activities never prompt the same complaint twice – which is clearly laudable but seems extremely unlikely. We would encourage Ofgem to investigate this further and ensure that the definition of 'repeat complaints' is sufficiently demanding and reflective of customers' experiences. If it emerges that DNOs financially reward customers for not making complaints, we suggest that they are given an obligation to report on any instances of this.

*OUTQ6: Do you agree with our proposal to remove the Stakeholder Engagement and Consumer Vulnerability Incentive in RIO-ED2?*

We agree with removing the financial incentive for stakeholder engagement in line with the expectation that, in RIO-2, high quality stakeholder engagement should be regarded as business as usual. We also think that the new proposed package of measures related to consumer vulnerability are an important enhancement compared with ED1, so the replacement of the Consumer Vulnerability Incentive is appropriate as part of that.

#### Meet the needs of consumers and network users: Connections

*OUTQ7: Do you agree with our proposal to expand the connections element of the customer satisfaction survey?*

Yes, this survey must be extended to reflect the views of new, distributed energy participants. We agree with Ofgem's proposal to include these connecting customer groups in the survey if it is satisfied that they are not currently being served by competitive alternatives to the DNO.

*OUTQ8: Do you consider that we have identified the relevant considerations to determine which customers should be captured in its scope?*

Ofgem has proposed that the scope of the survey be expanded to include the increasing volume of distributed/decentralised energy market participants. We agree that the scope should be expanded to ensure that the views of these parties are fully captured so that the DNO is incentivised to address any barriers to their participation in energy markets. The considerations used to determine the right customer groups to include look appropriate.

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

We agree with the proposal to retain a financial incentive for timely connections as this will remain a critical area of performance during ED2. Retaining the current value of +/-0.4% looks reasonable.

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

We note that, although standards have broadly improved during the period, results have been variable with several companies' performance appearing to deteriorate in some years. As a result, we support the proposal to use a reopener to revisit targets for this incentive during the price control, with the option to introduce penalties if service standards deteriorate.

*OUTQ11: Do you agree with the methodology we propose to use to set the new TTC targets?*

Yes, the methodology looks reasonable given the fairly wide range of performance across companies in ED1.

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*OUTQ12: Do you have views on our proposed Connection Principles and associated standards (in Appendix 4) for RIIO-ED2? Do you disagree with any of the standards we have proposed? If so, why?*

As elsewhere in the methodology, we agree with the principle of now expecting improved service standards from ED1 to be banked as business as usual in ED2. We also agree with the two part structure of this incentive, incorporating the requirement for a strategy that clearly meets the baseline standards, but with the opportunity to receive a CVP reward if the strategy reveals high standards that could be applied to all DNOs. We also support the use of a financial incentive, judged through an ex post assessment, as a way to hold companies to account for delivery of their strategies and to incentivise them to go further. The connection principles and standards set out look appropriate.

*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?*

We support the intent behind this approach and think that offering a CVP reward through the BPI could be an effective way to encourage companies to offer up higher standards that could be applied to all DNOs. However, it will be important for Ofgem to learn the lessons of the application of the CVP in other RIIO-2 sectors, and to be explicit about what level of evidence will be expected to support a successful CVP bid, especially if it is one that is using bespoke measures.

*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?*

*And OUTQ15: Do you consider that an assessment of performance in the middle and at the end of the price control is a proportionate approach?*

Yes, we support the use of an ex post assessment, and carrying out these checks in the middle and at the end of the price control looks appropriate. We note that Ofgem's thinking behind the incentive strength is ongoing and will depend on how many of a company's market segments do not pass the competition test. That is a reasonable way to ensure that incentives are targeted where there is most need. But there is clearly a risk that the uncertainty about the strength of this incentive (which may not be decided until Final Determinations) may deter companies from investing time in developing well worked through plans that stretch performance. Ofgem should consider the balance of risks in this area and consider whether it is worth clarifying the incentive approach earlier in order to stimulate company thinking effectively.

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

Yes, we agree with retaining the guaranteed standards of performance for connection customers.

*OUTQ17: Do you agree with our proposed approach to uplifting the Connections GSoP payment values in line with inflation, indexing payment levels to inflation, and rounding to the nearest £5?*

Yes, we agree with this approach.

*OUTQ18: Do you agree with our proposal to remove the Incentive on Connections Engagement for RIIO-ED2?*



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Yes, we agree with the philosophy that is used throughout the RIIO-2 methodology that high quality stakeholder engagement (which has been financially incentivised throughout RIIO-1), should now be regarded as business as usual.

#### Meet the needs of consumers and network users: Consumer Vulnerability

*OUTQ19: Do you agree with our proposed approach to ensuring consumers in vulnerable situations receive an appropriate range and level of support in RIIO-ED2? If not, what alternative approach should we consider?*

Overall, we welcome Ofgem's proposals for consumers in vulnerable situations which includes: a licence obligation to treat customers in vulnerable circumstances fairly; a set of principles-based baseline standards; a requirement to develop a specific strategy to deal with vulnerability issues which will be assessed against the baseline standards as part of the first stage of the Business Plan Incentive assessment and with the possibility of a CVP reward under stage two if the strategy reveals higher standards that could be applied to all DNOs; an ex post assessment of delivery, with the opportunity for both reward and penalty (valued at +/- 0.5% of revenue); and the opportunity to apply for Network Innovation Allowance (NIA) funding for vulnerability projects. We consider this package to be an improvement on that used in ED1.

In particular, we welcome the introduction of more explicit minimum standards in this area which is a significant improvement on the approach taken in the RIIO-2 methodology for gas distribution. We also support the broader definition of vulnerability to include consumers who may be at risk of different forms or higher levels of detriment as a result of being left behind by the ongoing energy system transition. Finally, we welcome the ongoing collaborative work by the companies to develop a common approach to measuring social return on investment (SROI). A practical, proportionate and consistently applied SROI tool will be one important way for Ofgem to assess the value delivered to consumers in this area. We think the incentive strength of 0.5% is appropriate to incentivise delivery.

However, taking the package together, we consider that there is also a risk that it may not be sufficient to drive significant innovation and improvement in this important area especially given the significant focus that companies will have to give to transition and whole system issues during the price control period. This risk comes from: the unproven effectiveness of the CVP; plus, the fact that any financial rewards will be delayed until mid-way through the price control period and are themselves uncertain given that the assessment approach against minimum standards is new.

*OUTQ20: Do you have views on our proposed Vulnerability Principles and associated standards (in Appendix 5) for RIIO-ED2? Do you disagree with any of the standards we have proposed? If so, why?*

We welcome the setting out of principles and associated standards in this vital area and support the standards that are set out. In particular we welcome the emphasis on:

- a 'sophisticated' and 'proactive' approach to the management, promotion and maintenance of a PSR register
- having in place an effective strategy for data use, including data sharing
- making clear that the DNOs' identification of vulnerability should not be limited to PSR categories (which do not include fuel poverty or low income, for example).

We note that the standards set out in detail the activities (or inputs) that the DNOs should be undertaking but they don't set out an expectation that DNOs should be able to demonstrate good

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outcomes in this area. We suggest that the standards make this clear – so, for example, that DNOs are expected to demonstrate that they have registered an appropriate number of people on the PRS register each year, and evidence that PSR data is up to date.

*OUTQ21: 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?*

*And OUTQ22: Do you consider that an assessment of performance in the middle and at the end of the price control is a proportionate approach?*

We strongly support an ongoing mechanism to hold companies to account for delivery in this important area, and to incentivise improvements.

We broadly support the approach of an ex post assessment, with one assessment during the period and a second at the end. We also note that companies will also still be required to report annually on the delivery of their strategy. We do have some concerns that only two assessments could leave significant problems unaddressed for some time. To minimise this risk, we suggest that the mid-period review is carried out in year three (to assess years one and two), rather than in year four, as the ED2 working group has suggested. The CEGs will also be able to play a useful role here to review progress and hold companies to account for delivery on their strategies. As a further mitigation, Ofgem could also consider giving the CEGs the ability to flag any significant concerns during the period to the regulator (having first escalated them to the company's board), with the ultimate possibility of this leading to enforcement action.

#### Maintain a reliable network

*OUTQ23: Do you agree with our proposed approach to retain the RIO-ED1 methodology for setting unplanned interruptions targets?*

*And OUTQ24: Do you have views on the alternative approaches to setting unplanned interruptions targets set out? Are there any other approaches that we have not considered?*

The arguments to retain the current methodology are reasonable and address the key learning points arising from experience of setting targets for, and operating, the ED1 incentive mechanism. However, see our point below on setting out the cost-benefit evidence in support of not revisiting targets during the ED2 period.

*OUTQ25: What are your views on revisiting unplanned interruptions targets within the price control period?*

The logic for Ofgem's proposal not to revisit these targets during the price control is reasonable. In summary, it argues that the cost (to the regulator and to companies) of revisiting targets is high, and the risk of rewarding companies again for service levels already achieved (and so of consumers' paying twice for these improvements), will be limited by a number of factors. These include: setting targets as late as possible before the start of the price control; using the lower (and so more demanding) end of the range of current performance; and the fact that the shorter, five year period of the price control means the chance of significant unwarranted reward is limited compared with ED1. We agree that these factors are likely to limit the risk here. We also believe that setting static and stretching targets provides a better (more certain) incentive for companies to deliver further improvements, particularly those who are operating near to frontier performance. However, in order to build confidence in its rationale, we think that Ofgem should set out the workings for the cost-benefit analysis behind its proposal.

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*OUTQ26: Do you agree with our proposed position not to introduce further convergence of DNOs' targets over time?*

The arguments for retaining the current methodology are reasonable, and we agree that companies should be driven to deliver equally high performance for all consumers, when accounting for network characteristics, customer densities and environmental conditions. As the key argument against setting the same absolute target for all DNOs across GB is that this would impose higher costs on customers in certain areas than others, we believe that this should be further explored as part of the stakeholder engagement agenda. The cost-benefit balance is also unlikely to be static into the future, as customers' lifestyles change, LCTs become more widespread, and demands on electricity networks alter. We also note that for CMLs, while most DNO areas are operating within a band of 35 minutes, plus or minus 10, there are one or two outliers. We suggest that Ofgem investigates whether a tailored approach for DNO areas that are consistently outside the band would be appropriate, to bring performance closer to the rest without prompting excessive bills for consumers in the area.

*OUTQ27: What are your views on retaining an incentive for planned interruptions performance, and the associated targets?*

We support the proposal to retain an incentive for planned interruptions performance.

*OUTQ28: What are your views on the potential amendments that could be made to the mechanism, including (but not limited to) the options presented in Tables 23 and 24?*

We recognise that customers can be warned about planned interruptions, but it is unclear currently whether these warnings are effective or whether customers are, in practice, able to respond to the warnings in a way that mitigates the impact of the interruption. We support Ofgem's proposal to reject the idea of different weightings (between planned and unplanned interruptions) for DNOs based on their own customers' experiences and views. However, we do see merit in Ofgem's testing the proposed weighting with a sample of GB consumers and customers to see whether the current approach (with half the weighting on planned interruptions compared with unplanned interruptions) adequately reflects customers' experiences and views. If this insight indicates that a new weighting is needed, then we would support continuing to apply the same (revised) weighting across all DNOs.

*OUTQ29: What are your views on how VoLL should be updated for RIIO-ED2?*

*And OUTQ30: What are your views on the different methodologies for updating VoLL?*

*And OUTQ31: Do you have a view on retaining alignment with VoLL figures used in other RIIO price controls and/or parts of the energy sector?*

We agree that VoLL should be updated to provide appropriate incentives. While Ofgem's proposal is to retain a single VoLL figure for the price control, we think there is merit in considering other approaches, such as:

- VoLL for different customer groups based on the value that they place on a secure supply.
- VoLL that is differentiated by essential or non-essential demand.

Either of these approaches could more accurately signal the value that different customers place on different types of demand. Such differentiation could potentially lead to significant reductions in

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investment requirements. This topic is also being addressed by the Electricity Engineering Standards Review Panel, formed by BEIS and Ofgem,

We think that having different VoLL values that better reflect the requirements of customers, or different types of demand could bring benefits, but frequent changes will add complexity and may not make a significant difference to the IIS incentive properties, or the network reliability provided to customers.

*OUTQ32: Do you agree with our proposed approach to retain the RIO-ED1 revenue cap for the IIS at 250 RoRE basis points?*

Yes, we think this is an appropriate level within the overall package of incentives.

*OUTQ33: Do you agree with our proposal not to introduce an incentive on short interruptions in RIO-ED2? If not, how should such an incentive be structured and developed?*

*And OUTQ34: What are your views on a minimum standard for short interruptions for RIO-ED2?*

*And OUTQ35: What information should we be capturing in RIO-ED1 and RIO-ED2 to better understand short interruptions and how DNOs are performing?*

We agree with Ofgem's proposal to gather evidence during the rest of ED1 and through ED2 with the expectation of establishing an incentive for short interruptions in ED3. We agree that consumer habits and lifestyles are changing rapidly which may well increase consumer dissatisfaction with repeated short interruptions. We would also suggest that, rather than depending on regulatory mechanisms to incentivise companies to gather the right consumer experience data here (which is a slow and uncertain method), Ofgem could accelerate this process by running a research exercise centrally with the potential to reveal this evidence more quickly and, if it is justified, to introduce an incentive in the latter years of ED2.

*OUTQ36: Do you agree with our proposal to retain the RIO-ED1 SWEE mechanism?*

Yes, we support the proposal to retain the severe weather extraordinary events mechanism but to ensure that the current threshold approach is fit for purpose.

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

We support the proposal to remove the 'other extraordinary events' mechanism, unless Ofgem receives compelling evidence from other responses that changes could be made to ensure there is no scope for abuse, and its original intent can be achieved without undue regulatory overhead.

*OUTQ38: What are your views on the threshold that should apply to either exceptional event mechanism?*

We have no further comments in this area.

*OUTQ39: What performance do you think should be excluded under each mechanism?*

We have no further comments in this area.

*OUTQ40: Do you agree with our proposal to retain the existing GSoPs? If not, what changes do you think are necessary and what are the reasons for them?*

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We support retaining the existing GSoPs although Ofgem should make every effort to identify whether the current standards adequately reflect consumer and customer experience. For example, is two days' warning of a planned interruption sufficient for consumers to avoid significant inconvenience or other detriment, and are company warnings effective in reaching and alerting consumers to their plans?

*OUTQ41: Do you agree with our proposal to uplift payment values in line with inflation, indexing payment levels to inflation, and rounding to the nearest £5 for clarity for stakeholders?*

Yes, we support these proposals, and the intention to explore how compensation for all the remaining standards could be paid automatically without the need for customers to make a claim.

*OUTQ42: Do you agree with our proposal to retain some form of mechanism for WSC in RIIO-ED2?*

We agree with the proposal to retain a mechanism to protect companies' worst-served customers, and that improvements are needed to address the fact that so little of the available ED1 funding has been successfully claimed by DNOs and invested in improvements for these customers.

*OUTQ43: What are your views on the options presented for WSC? Are there other options that we should consider?*

We have no further comment in this area.

### Maintain a safe and resilient network

*OUTQ44: Do you have any views on our proposed NARM framework?*

The NARM monetised risk metric is a key factor for justifying need cases and assessing CBAs, and we would like to see good quality information being provided in DNO plans. However, we are concerned that any shortcomings or data immaturity in this metric could both prejudice upfront decision-making and reduce certainty in the measurement of actual risk reduction benefits delivered to customers.

Given the risk of significant volatility in the monetised risk calculations in submitted plans, we would like to see NARM's evidence corroborated by other data such as details of actual asset condition. We are concerned that the NARM data and methodology is relatively immature and cannot be solely relied upon for decision making. We agree that NARMs are a useful tool and that a wider toolkit is required to justify investment decisions.

We welcome the steps that are being planned for RIIO-ED2 to improve the quality of NARMs data and ensure better alignment and consistency across the sector. We support the development of guidance to support this process. We would also support a clear goal, during ED2, to gather data in order to extend NARMs to cover those asset cohorts that are currently out of scope. In particular, we would welcome an early focus on overhead line conductors and pole-mounted equipment. In the meantime, we believe that Option 1 may be the best compromise mechanism for out-of-scope areas, both on grounds of simplicity, and on assuring customers that DNOs have delivered against allowances for this planned investment.

We also believe very strongly that Business Plans should contain well-structured CBAs and EJPs to underpin proposals for investment. Learning from other sectors, it is important that clear expectations are set for companies to meet, including submission of CBAs and EJPs at the same time as submission of the main business plan documentation, and the requirement for granularity and

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supporting asset condition and criticality data. It is also important that these CBAs and EJP's properly address all of the alternative options available to reduce asset risk, in order to justify the chosen option.

We agree that the DNOs should be incentivised to deliver their NARM outputs, and that allowances should be returned where a target has not been realised.

*OUTQ45: Do you agree with our proposal not to introduce outputs or incentives related to workforce resilience?*

Yes, we agree with this approach – we think workforce resilience should be a business as usual activity for the companies.

*OUTQ46: Do you agree with our proposal that DNOs should submit a Cyber Resilience IT Plan and a Cyber Resilience OT plan?*

Yes, we agree with this approach. While we expect the content to be confidential, we expect these plans to be submitted to Ofgem in a timely manner and that overall costings should be declared in business plans, providing evidence to support that there has been no duplication of costs.

*OUTQ47: Are there further requirements of expectations that we should be considering for the DNOs?*

We have no further comments.

*OUTQ48: Do you agree with our proposal for the establishment of a 'climate resilience' taskforce or working group, to help DNOs develop strategies for managing the risks of climate change?*

*And OUTQ49: How should DNO strategies inform best practice that is used across the industry? How can these be used to help DNOs develop longer term investment proposals to manage the risks of climate change?*

This co-ordinated and strategic approach, building on steps already taken by DNOs and others, is welcomed. The co-ordinated monitoring of resilience risks and developing mitigation strategies should provide a valuable contribution to developing future expenditure plans.

*OUTQ50: Do you agree with our proposal to retain the RIIO-ED1 approach to flood resilience?*

Yes, we agree that the retention of the RIIO-1 approach of providing flood risk allowances is appropriate.

*OUTQ51: What are your views on how we/industry reports on progress against flood resilience plans?*

We welcome the proposal to try and develop a wider 'resilience metric' over the price control period so that flood resilience can be tracked, with a potential output being defined for the ED-3 period.

*OUTQ52: Do you agree with our proposal to retain the RIIO-ED1 approach to ensuring networks are resilient to trees?*

Yes, we agree that the retention of the RIIO-1 approach for tree cutting allowances is appropriate.

*OUTQ53: Do you agree with our proposal to develop a wider resilience measure over the course of RIIO-ED2? If so, what should it cover?*

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We welcome the proposal to try to develop a wider 'resilience metric' over the price control period so that vegetation issues can be tracked, with a potential output being defined for the ED-3 period.

*OUTQ54: Do you agree with our proposed approach of retaining the existing arrangements for Black Start, physical security, and telecommunications resilience?*

Yes, we agree that the retention of the RIO-1 approaches is appropriate.

*OUTQ55: Do you agree with our proposal to include a reopener for physical site security, with a window during the price control and a window at the end of the price control?*

Yes, we agree with this approach.

*OUTQ56: Do you agree with our proposal to continue monitoring the development of telecommunications resilience and reviewing the arrangements as necessary?*

Yes, we agree with this approach.

### Delivering an environmentally sustainable network

*OUTQ57: Do you think our proposed environmental framework will drive DNOs to deliver an environmentally sustainable network?*

The draft ED2 methodology introduces a new environmental framework for the companies with a clearer expectation than for ED1 on common methodologies and more consistent environmental reporting against long-run targets. Over time, the requirement for an EAP and clearer annual reporting (via the AER) will allow the companies, the ENA, Ofgem and wider stakeholders to build a better-informed and more accurate environmental picture – including cross-sector and cross-vector. This is very welcome.

However, across key environmental outcomes, the draft ED2 methodology proposes only relatively weak reputational output incentives (for AER reporting, for losses, for SF6 leakage). In some instances, these incentives are actually weaker than in ED1. We question how far the proposed set of reputational incentives will successfully deliver an environmentally sustainable network.

By contrast, for some key ED2 areas a new mechanism is proposed that requires the companies to develop strategy delivery incentives (DSO, large connections and vulnerability). This is welcome. These SDIs meet Ofgem baseline requirements but also crucially include a financial incentive to ensure that the companies deliver against their strategies and are motivated to go further. These strategy delivery incentives will be assessed by Ofgem mid-period plus at the end of the price control, taking account of performance against pre-defined metrics but not purely mechanistically. This seems to provide an appropriate balance of a quantitative and qualitative incentive in what are complex areas.

We should like to see an equivalent 'strategy delivery incentive' adopted to drive environmental progress, in particular for decarbonisation and Net Zero. This could bring together a cross-cutting incentive mix: clear minimum standards, a mechanism to ensure companies deliver on commitments, financial incentives with some metrics to stretch performance, plus reputational incentives where environmental outputs are not yet readily measured. A strategy delivery incentive for an environmentally sustainable network would allow Ofgem to send a stronger and more concerted signal to the companies on the value of decarbonisation and Net Zero to consumers and future consumers.

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The draft ED2 methodology indicates that Ofgem is open to evidence on how financial incentives for environmental outputs could drive additional value for consumers in a manner which is measurable and does not create perverse incentives on companies. We note that for NGGT and NGET Ofgem is proposing to accept a financial incentive based on a scorecard of EAP metrics. In its decision Ofgem said *'we consider that an ODI-F would ensure NGET has a financial interest, proportionate with its involvement and effort, in achieving or exceeding the RIO-2 targets set out in its EAP'*. This summarises well the rationale for a financial incentive in this area. Ofgem has put careful thought into the design of the NGGT/NGET incentive to weight the different metrics appropriately. While this EAP scorecard feels to us less flexible than an in-the-round 'strategy' approach, it demonstrates that quantification is possible and may provide a useful starting point for a broader strategy delivery incentive.

*OUTQ58: Do you consider that the proposed areas in scope of the Environmental Action Plan, and associated baseline standards, are appropriate? We particularly welcome views on any areas that should be omitted/included and if new areas should be included, what the baseline standard should be?*

We note the proposed split in scope of the Environmental Action Plan (EAP) between 'decarbonise the networks'<sup>5</sup> and 'reduce the wider environmental impact of network activity'<sup>6</sup>, which is a helpful distinction. We also note that the proposed baseline standards for each area reflect rather mixed ambition-levels and these continue to be debated in Ofgem's ED2 Decarbonisation and Environment Working Group<sup>7</sup>. Since initial design of ED1 incentives over six years ago, new Net Zero requirements have changed the picture fundamentally. We have a real practical concern that Ofgem's approach in ED2 to the environmental baseline standards for decarbonisation is largely incremental rather than a 'step-up'.

Company commitments on baseline standards – made via Environmental Action Plans – will be reflected in business plan base-line funding bids. Stronger environmental ambitions should lead to good outcomes for companies from the consumer value proposition in the Business Plan Incentive.

However, progress on those commitments during the price control period - reported via Annual Environmental Reports (AERs) - will depend for delivery largely on a reputational incentive - unless treated as PCDs<sup>8</sup>. If faced with a tight price control, companies will look to make savings where they can. While many have a strong corporate commitment to a sustainability agenda, this may come under pressure should investors face lower returns. We can already see this in water. A reliance on reputational incentives alone is therefore not adequate for this critical area. While PCDs may help on non-delivery, on their own they do not provide a sufficient incentive on companies to continue to look for opportunities to go further in the price control period - which a financial incentive as part of a strategic delivery incentive would do - and as outlined in our response to questions 56 & 57.

On business carbon footprint and the EAP, Ofgem's position on science-based targets needs to be clarified. Ofgem indicates that companies should sign up to these - described as targets that are

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<sup>5</sup> Decarbonise the network: BCF, Losses, SF6, Embodied carbon (Annex 1. Table 41. P 141. Proposed Scope of the EAP)

<sup>6</sup> Reduce the wider environmental impact of network activity: supply chain management, resource use and waste, biodiversity and natural capital, fluid filled cables, noise, NOX & air quality. (ditto)

<sup>7</sup> Annex 1. Table 42 para 9.16, p 143 & Appendix 8 (p 189).

<sup>8</sup> Price-Control Deliverables – and which in general they were not in the T/GD draft determinations



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consistent with the Paris agreement<sup>9</sup> and net zero obligations in the long-term<sup>10</sup>. In practice, the science has continued to develop since the Paris agreement in 2015 and the Science Based Target initiative<sup>11</sup> now encourages companies to sign up to targets that are consistent with a 1.5 degree temperature increase. Importantly for RIO-ED2 this is also consistent with the UK's 2050 statutory position on Net Zero. Ofgem should therefore recognise this and clarify that DNOs should adopt science-based targets for their own emissions which align with 1.5 degrees. Although perhaps implicit, there would also be merit in making clear that the definitions on the scope of the emissions to be included in these targets should be consistent with the global Greenhouse Gas Protocol and the science-based targets initiative.

On Losses, see answer to question 61 below.

On SF6 while we recognise that leakage is much greater on transmission, this remains a highly potent greenhouse gas with a global warming potential ~23,000 times that of CO2. Having developed a financial incentive for SF6 leakage for ET we would expect the same incentive to be applied in ED to SF6 leakage – the unit value of savings from either sector should be the same provided a consistent value for the cost of carbon is used. For distribution, plans for SF6 containment and eventual safe disposal should be a priority. For distribution, SF6 is spread in far smaller volumes across a great many more individual items of equipment. Unless there is a real risk of leakage, to accelerate replacement before the end of asset-life would be costly and arguably of low consumer and emissions benefit<sup>12</sup>. As a minimum however there should be an expectation on DNOs to work collaboratively, including with transmission and the supply chain, to develop a network-wide strategy and plan into RIO-3 for safely reducing SF6 holdings over the long-run. This should then form part of whatever wider financial incentive is put in place for environmental performance.

We also note that, in terms of the cost of carbon, there is a consistency issue on what Ofgem expects companies to use for their investment appraisals - and hence inform their decisions on losses or SF6. To date, the guidance to companies has been to use HMT assumptions. However, Ofgem's own IA guidance talks about carrying out sensitivity assessments at the high-end of the HMT range. This is because HMT figures have not yet been updated for Net Zero. We ask Ofgem to ensure that the cost of carbon figure which the DNOs are expected to use in their cost assessments is transparent and consistent with Net Zero.

Last, the DSO role and remit and how this is to be incentivised will be absolutely central to successful long-run company approaches and outcomes to emissions reduction and Net Zero. Many others have a strong interest in the DSO role, and we do not propose to comment in detail here. However, we have a particular concern that the draft ED2 methodology is silent on the DSO role in terms of both approaches to decarbonisation and also to Net Zero. In the DSO principles, the sole reference to carbon relates to providing information, inter al, on the carbon content of plant despatched for ancillary services. There seems to be a very strong case for the DSO to have a specific 'Net Zero' duty right across its role – with respect to network investment decisions, connections, operations and despatch. This would sit well as a part of our proposed 'strategy delivery incentive' approach to incentivising DNO decarbonisation and Net Zero.

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<sup>9</sup> Annex 1. Footnote 117. P 143

<sup>10</sup> Annex 1. Para 9.12. p 142

<sup>11</sup> <https://sciencebasedtargets.org/step-by-step-guide/>

<sup>12</sup> albeit new environmental regulations on SF6 phase-out would change the picture

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*OUTQ59: Do you agree that the annual reporting through the Environmental Impact Report will increase transparency of the DNOs' activities and the resulting impacts on the environment?*

Environmental impact reports are an ED1 licence obligation but are not produced on a consistent or comparable basis.

Therefore, and as noted in Q56, the requirement for clearer annual reporting in ED2 via the Annual Environmental Report (AER) will allow the companies, the ENA, Ofgem, and wider stakeholders to build a better-informed and more accurate environmental picture – including cross-sector and cross-vector. The AER reports are an essential building block in gaining clearer understanding of what additional actions may be needed in the networks to make timely progress towards Net Zero. Ofgem must also consider its own role in consolidated annual reporting.

However, as noted in our responses above to questions 57-58, we have considerable doubts that the proposed EAP & AER framework incentive proposals – in particular with respect to decarbonisation and expectations on BCF targets – can be looked to drive the required environmental outcomes and impacts towards Net Zero.

*OUTQ60: Do you agree with our proposal to introduce a re-opener to accommodate environmental legislative change within the RIO-ED2 period?*

We agree, but any such re-opener must be tightly drawn, including on materiality, and clearly delineated from the Net Zero reopener<sup>13</sup>. In ED2 its most likely use might be associated with legislation to phase-out SF6. Or perhaps less likely, a future change to current thresholds for eliminating PCBs in small pole-mounted transformers.

*OUTQ61: Do you agree with our proposed removal of the Losses Discretionary Reward?*

We recognise that losses are a complex area but are very concerned that Ofgem seem to be going backwards compared to ED1.

We do not agree that losses should be incentivised by a reputational incentive only. See our answer above to Q57 on the need for a decarbonisation strategy delivery incentive which would incorporate a financial incentive, including with respect to losses.

The ENA has overseen a review of losses treatment<sup>14</sup> – and has put forward a proposal for a losses reputational incentive with life-cycle CBA, which Ofgem seems inclined to adopt (albeit how CBA outcomes on losses will be factored into investment plans is still being discussed). In addition, without proposing any meaningful alternative, we disagree with Ofgem's proposal to drop the ED1 Losses Discretionary Reward (which Ofgem describes as a reputational incentive – but has a financial dimension). In the long term – once the grid is fully decarbonised – the association of losses with carbon emissions will cease. However, at around 95% today of all DNO Scope 1 and 2 emissions, losses will remain the dominant source of carbon emissions associated with DNO operations in ED2. For the long-term, losses will also remain a very significant efficiency issue. Meeting the electricity

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<sup>13</sup> Annex 2. Para 11.23. p 94 Purpose : A re-opener to recover costs associated with compliance with environmental legislation Benefits : To ensure that DNOs are funded efficiently in line with changes to environmental policy and legislation

<sup>14</sup> WSP report for ENA. September 2019 CEP023 TECHNICAL LOSSES MECHANISM STUDY Development of a Losses Incentive Mechanism: Phase 1 Final Report  
<https://www.energynetworks.org/assets/files/CEP023%20Technical%20Losses%20Mechanism%20Study%20Final%20Report.pdf>

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capacity requirements for electrification of heat and transport will be all the more challenging and expensive if, on average, 6% of the renewable energy generated continues to be lost through distribution losses.

Losses will increase with new network investment, more renewables and also operating networks nearer their physical limits. Ofgem has said it does not want to favour one output over another. However, the ED2 proposals risk doing just that by putting a financial incentive on connection of LCTs - but not at the same time on loss reduction. The networks need to be incentivised to balance these considerations appropriately. While Ofgem has signalled that it will allow the costs of low-loss equipment in baseline allowances (where the case is made), as it stands, there is nothing to stop companies ultimately opting for cheaper equipment in a quest for efficiency savings.

The merit of the Losses Discretionary Reward (or an updated version – as part of a new decarbonisation strategy delivery incentive as proposed, above) is that this would provide the flexibility to cope with the complexity inherent in losses while retaining a focus on losses through a strong (i.e. financial) output incentive for the companies to identify controllable losses and do more to manage them.

*OUTQ62: Do you agree with our proposal to retain the visual impact allowance for RIIO-ED2?*

Yes. We note that Ofgem feels that the scheme has worked well and flexibly in ED1.

We would expect Ofgem to engage directly with relevant statutory and non-statutory bodies (including those which are representative of interests beyond National Parks and AONBs) to understand their thinking on the merits of rolling forward the scheme ‘as is’.

*OUTQ63: Do you agree with our proposed approach to setting a funding pot for the visual impact allowance for RIIO-ED2?*

We note that Ofgem does not propose to set PCDs for project outputs in RIIO-ED2 but will request DNOs to indicate in their Business Plans the likely value of under-grounding projects they could deliver. This seems important, as so far only around one-fifth of the total available allowance has been spent.

In setting a pot for ED2, it may be useful to consider the likely split of baseline spend and possible spend beyond baseline (i.e. agreed later in the price control period).

On WTP, it is noted that the last distribution-level WTP research on undergrounding was some time back (DCPR5). Ofgem indicate they may use the ET2 WTP research from NERA to inform its decision. We would encourage Ofgem to seek the views of the statutory and non-statutory bodies on how far they would regard transmission WTP research as relevant.

## Annex 2: Keeping bills low for consumers

### Approach to aggregated econometric analysis

*COQ1: Do you agree with our proposal to include totex benchmarking in our toolbox for cost assessment in RIIO-ED2?*

We agree that totex benchmarking should be used.

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*COQ2: What cost drivers do you consider appropriate for our proposed totex benchmarking? Why?*

The main non-load cost drivers for distribution networks should be asset related to maintain satisfactory asset health. Load related expenditure will be driven by connections of new capacity, although some of this may be generation that reduces pressure on the network. As described above, the energy transition will drive both increases and decreases in expenditure.

In order to ensure comparability, we suggest that totex benchmarking should be adjusted for energy transition variables where these can be separated.

*COQ3: What are your views on the use of both historical and forecast data in our modelling?*

We agree that totex benchmarking should be used and that this should be based on DPCR5 and RIO-1 data. We think that the vast majority of DNO activities have changed little over the period, and that overall system demand was higher during DPCR5. We are concerned about placing undue reliance on company forecasts for RIO-ED2, given that company expenditure bids may be higher than necessary.

*COQ4: At what level should we set the efficiency benchmark?*

We agree that the historic levels of outperformance justify the use of an 85% percentile.

*COQ5: Do you agree with the proposed criteria for developing cost pools for a middle-up approach?*

We support the identification of cost pools and agree this is an appropriate approach to explore further. It may be helpful in addressing potential errors in aggregated regressions – for example some of the energy transition variables.

*COQ6: What cost drivers would be appropriate in a middle-up approach?*

We think this approach could be used to assess the trade-offs in expenditure between business as usual and non-network flexibility solutions or active network management solutions. These might have a network utilisation cost driver.

*COQ7: What are your views on the CEPA developed totex and opex plus approach? What opex activities are there trade-offs that support the rationale for testing 'totex and opex plus' modelling?*

Other approaches such as this one may be valuable, but we would suggest that an early decision is made on the approaches that will be used such that an effective assessment process can be established, and clarity is given to companies on the information and justifications they must provide.

*COQ8: Do you believe it is appropriate to use bottom-up, activity-level, disaggregated modelling in RIO-ED2?*

Given the changing cost drivers and cost trade-offs emerging for RIO-ED2, we think it would make sense to have a disaggregated model that is available to use for analysis. A top down approach may not be able to reflect all these changes.

*COQ9: If we use a combination of aggregated and disaggregated modelling approaches, how should we determine the weight we apply to each, in combining our analysis?*

This should be determined based on the confidence that Ofgem has on each model results. Ofgem should take account of its past experience in using these models but should not take the decision until the evidence and results for RIO-ED2 have been fully assessed.

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*COQ10: If we did not use disaggregated modelling approaches, what approach should we consider for disaggregating totex allowances for the setting of PCDs?*

We think PCDs should be set based on the most accurate modelling approach, so if Ofgem has greater confidence in the disaggregated model for a particular PCD, then this should be used.

#### Model specification

We have no specific comments to make on the regression model specification criteria. Again, we suggest Ofgem bases its decisions on past experience, but also recognises the additional energy transition variables applicable for electricity distribution.

*COQ11: What model estimation options should be considered for our cost assessment and why?*

*COQ12: Do you agree with our proposal to continue using Cobb-Douglas functional form? Why?*

*COQ13: Do you have any views on our proposed model selection criteria?*

#### Regional and Company Specific Factors

We have no specific comments to make on the regional and company specific factors.

*COQ14: Do you agree with the proposed criteria for assessing regional and company specific cost factors that we have outlined?*

*COQ15: What are your views on our approaches to account for regional and company specific cost factors in our modelling?*

#### Real Price Effects and ongoing efficiency

*COQ16: Do you agree with our proposed approach to index RPEs, rather than setting an ex ante allowance based on forecasts?*

Overall, we are concerned that Ofgem is proposing to include some RPEs, that are within the management control of the company. Where these provide additional scope for outperformance, we would expect Ofgem to take this into account in the calibration of expected totex outperformance. We agree with the proposed approach to index RPEs which will reduce the risk of forecasting errors.

*COQ17: Do you agree with our proposal to have a high materiality threshold for RPEs? What are your views on the materiality level for RPE submissions, and the criteria we use to select input price indices?*

We agree that a high materiality index should be set for RPEs. We suggest that consideration be given to whether some should be included at all given that companies already have protection from inflation increases.

*COQ18: Do you agree with the suggested common input and expenditure categories for structuring RPEs in ED2?*

Yes, we agree with the proposed RPE categories and that the RIO-ED1 parameters should be used again.

*COQ19: Do you agree with our proposed approach, and its scope, to set an ongoing efficiency assumption for RIO-ED2?*

## RIIO-2 Challenge Group

### Response to RIIO-ED2 Methodology Consultation

Yes, we agree that stretching targets for ongoing efficiency improvements should be included. The companies have significant opportunities for additional efficiency improvement through smart network innovations, and the use of non-network flexibility contracts. These efficiency savings should also be included in these targets.

*COQ20: Do you agree with our proposal to use a growth accounting approach as our primary source of evidence to set an ongoing efficiency assumption? What parameters would best support this approach?*

We note Ofgem's proposal to use a growth accounting approach to estimate the value of historical productivity improvements and to estimate future gains, and that this will be supported by analysis of DNO past performance, benefits from innovation funding, and other information.

In reviewing DNO past performance, we suggest Ofgem should assess the outturn of the smart system benefits identified by DNOs in RIIO-ED1. In the RIIO-ED1 draft determination, Ofgem identified the following areas<sup>15</sup> where savings were expected. Future savings may be expected in future price controls and should be captured in efficiency targets.

**Table 11.1: List of smart solutions**

DSM/DSR
Dynamic line ratings
Dynamic network automation and associated advanced load modelling
Dynamic transformer ratings
Energy efficiency
Enhanced automatic voltage control
Fault current limiter
Installation of power line carrier system for data comms
Intelligent control devices (EVs)
Network meshing
Phase shifting transformer
STATCOM
Switched capacitors
Voltage gradient approach to LV fault finding

### Disaggregated cost assessment

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

We note that Ofgem is proposing that DNOs develop a core baseline scenario and that DNOs should set out the investment to meet this scenario. The DNOs would prepare a common set of scenarios but would then base their individual plans on their own best view.

Load related expenditure currently forms around 10% of total expenditure for the DNOs but is an area that faces significant uncertainty due to the energy transition and changing supply and demand landscape. Expenditure forecasts will be driven by customer requirements and these will need to be represented by a baseline scenario.

We are concerned that the process for developing common and consistent scenarios is unclear and may lead to incomparable plans being produced. We suggest that clear guidance is given to DNOs for the preparation of consistent and comparable plans which include a 'common view' which can be reconciled with FES forecasts, for example.

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

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<sup>15</sup> [https://www.ofgem.gov.uk/sites/default/files/docs/2014/07/riio-ed1\\_draft\\_determination\\_expenditure\\_assessment.pdf](https://www.ofgem.gov.uk/sites/default/files/docs/2014/07/riio-ed1_draft_determination_expenditure_assessment.pdf)

## RIO-2 Challenge Group

### Response to RIO-ED2 Methodology Consultation

We agree that there is a need for greater network monitoring so that utilisation can be more closely assessed and managed. However, we would expect to see robust justification for any additional network monitoring expenditure, given that much of this information will already be available from the DCC and Electralink monitoring services.

We support this information being digitised and made more widely available to enable improved network operation.

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

Yes, we agree that network and non-network options should be developed and compared wherever possible. In addition, these options should consider whole system solutions where the benefits (or costs) may also impact transmission systems or balancing costs, for example.

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

The fixed costs of procuring flexibility should be included in the cost benefit assessments alongside fixed costs of procuring new assets.

*COQ25: What are your views on the use of LIs as outputs in RIO-ED2?*

We think it should be useful to establish Load Index (LI) measurements in RIO-2 to measure how close the network is to operational limits. However, we note that this is only likely to be important in heavily constrained parts of the network which are already likely to be closely monitored so that the DNO can operate their equipment within technical and safety limits, on both a pre- and post-fault basis.

It is unclear whether this should be targeted as an output to ensure that the network utilisation is maximised within technical limits, or as a limit to ensure that the network and customers are not at risk. While monitoring of network utilisation should be useful, we suggest that more evidence is needed to justify the introduction of incentives around a Load Index output.

*COQ26: What are your views on the treatment of incremental costs in RIO-ED2?*

We agree that a different perspective needs to be taken to RIO-ED2 that recognises the role of strategic investment needed for Net Zero and the energy transition. The oversizing of assets as regular asset replacement takes place should be an appropriate way of enabling strategic investments. The use of CBAs to identify risks and benefits should be a useful decision-making tool.

Oversizing of replacement assets should help prepare for expected future demand increases. But any such investments should seek to mitigate the risk of stranded assets in case expected electricity growth does not emerge. Existing capacity headroom should be fully utilised as well as exploiting whole system benefits.

Future demand assumptions will be necessary to justify this incremental investment. In order to prioritise this investment and reduce the risk of stranded assets, incremental investment decisions should justify the future need for the capacity using common long-term demand scenarios.

*COQ27: Do you agree with our proposal to maintain the RIO-ED1 approach to assessing Non-op capex costs in RIO-ED2?*

Yes, we agree with this approach.

## RIIO-2 Challenge Group

### Response to RIIO-ED2 Methodology Consultation

*COQ28: Do you agree with our proposal to maintain the RIIO-ED1 approach to assessing NLRE in RIIO-ED2?*

Yes, we agree with this approach.

*COQ29: Do you agree with our proposal to maintain the RIIO-ED1 approach to assessing NOCs in RIIO-ED2?*

Yes, we agree with this approach.

*COQ30: Do you agree with our proposal to maintain the RIIO-ED1 approach for assessing CAIs in RIIO-ED2?*

Yes, we agree with this approach, including the separation of DSO costs.

*COQ31: What are your views on the different approaches presented for the treatment of BSCs in RIIO-ED2?*

We note that business support costs currently account for 11% of total cost allowances and companies are currently underspending by around 7%. We have no strong opinion on the alternative approaches but would wish to see ongoing efficiency improvements being incentivised.

### Cost Benefit Analysis

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

We think it is important to use CBAs to justify investment requirements and that these should be applied for asset categories or projects wherever possible.

Ofgem's sector methodology sets out that all CBAs should include an option that requires a minimal initial investment i.e. a 'do minimum' or 'business as usual' option to provide a reference scenario for comparison. Ofgem have requested a full list of investment options that have been considered, costed and discounted.

For each asset class/project, in addition to the business as usual case, we would like to see clear descriptions and consideration of alternatives for:

- scope of intervention approaches e.g. replacement, refurbishment
- cost of alternative interventions.

The CBAs should be closely linked to the Engineering Justification Papers (and NARMs) for each asset class/project, and key assumptions should be outlined. We think that the CBA assumptions and the associated sensitivity analysis should consider the following key drivers:

- asset health, including NARMs information
- ongoing cost efficiency improvements
- network demand, including future demand forecasts and future distributed energy resources
- ongoing flexibility/smart grid improvements.



## RIO-2 Challenge Group

### Response to RIO-ED2 Methodology Consultation

#### Engineering Justification Papers

We agree that EJP should be provided by DNOs to set out the need, options, scope, costs and benefits for asset health or capacity expenditure.

In preparing EJP it will be important for common information requirements to be specified.

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

*COQ34: Do you agree with our proposal retain the assessment framework for EJP developed as part of the RIO-2 process?*

*COQ35: Do you agree with our proposal to adopt the principles outlined above to guide the production of EJP and focus the engineering submission?*

#### Data assurance and compliance

*COQ36: What specific activities and methods should be adopted to ensure the Data, Data Assurance and Compliance processes of the RIO-ED2 price control are run as effectively as possible?*

The provision of accurate, complete, and timely information is essential for us to assess business plans as part of our Challenge Group responsibilities. As well as accurate and well justified information, we are seeking information that is consistent between, and easily reconcilable with, the individual components of the RIO-2 plans, and with the equivalent track records of RIO-1 past performance.

Ofgem's proposals to improve data processing exchanges during RIO-2 should be beneficial. We welcome the proposed improvements that this should enable to the annual RIGs process. We would suggest that this RIGs reporting information is made more openly accessible to customers and stakeholders of the distribution networks, allowing greater scrutiny of performance.

As data reporting processes are increasingly automated, we suggest that RIGs cost and performance information is made available more frequently, thereby increasing the time available for scrutiny and analysis and allowing greater insight into the decisions made by the companies and their customers.

#### Uncertainty mechanisms

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

We agree that the companies should have uncertainty mechanisms to address expenditures resulting from exogenous events and risks that are outside their control but should not be applied for expenditures where the risks lie within their control. Ofgem's proposals appear to strike the right balance.

The RIO-ED2 price control period is being set at a time where there is considerable uncertainty about the energy transition and future distribution network utilisation. Forecasting of expenditures and outputs will be impacted by:

- reduced network utilisation due to expected energy efficiencies, time shifting of demand from peak times, and increased output from distributed energy resources
- increased network utilisation due to forecast increases in electric vehicles and electric heating, and the policy decision to include incremental or anticipatory expenditure.

## RIO-2 Challenge Group

### Response to RIO-ED2 Methodology Consultation

- the current headroom on the networks given the decrease in electricity demand over the last 10 years or so.

Because of these uncertainties, we are concerned that RIO-ED2 baseline expenditure allowances will be either higher or lower than they need to be and agree that uncertainty mechanisms are necessary to adjust allowances accordingly. We think that baseline expenditure and outputs should use common utilisation parameters – for example, numbers of EVs, LCTs etc, forecast by each DNO, with the baseline activities and outputs clearly defined to allow adjustments, as necessary. The individual DNO forecasts should be aggregated and reconciled with a credible national scenario.

**Net Zero** – we welcome the introduction of this reopener and the flexibility that this mechanism provides.

**Co-ordinated adjustment mechanism (CAM)** – we welcome the flexibility that this adjustment mechanism offers in that it allows the transfer of activities and allowances between DNOs. It should help to balance expenditure between DNOs who are facing higher or lower expenditure due to higher or lower utilisation. We suggest that this mechanism should operate in advance of a Net Zero reopener being triggered – in other words, that the first actions in the price control should be to true up under/overspend between DNOs before adding additional expenditure through a Net Zero reopener.

**Strategic Investment uncertainty mechanism** - we welcome the introduction of this reopener and the flexibility that this mechanism provides.

**Other uncertainty mechanisms** - we agree with the proposed uncertainty mechanisms for cyber-resilience, tax, black start, physical security, smart meters, street works, rail electrification and environmental legislation. We agree with the items listed for pass-through costs.

We would expect Ofgem to define these uncertainty mechanisms clearly so that they operate only in the event of specified risks outside of company control, and that only efficient additional costs are allowed.

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

We don't think it is necessary to add additional uncertainty mechanisms. If additional mechanisms are added that reduce risk for companies (by passing risk to consumers), then we think Ofgem should consider reducing equity returns due to the lowering of risk faced by investors.

*COQ39: Do you agree with our proposed removal of the above uncertainty mechanisms for RIO-ED2?*

Yes, we agree with this approach.

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

Yes, we agree that there should be a common approach that sets clear criteria for the triggering of uncertainty mechanisms, and an effective process is needed for the submissions of evidence by companies and Ofgem decision making on changes to costs, volumes, outputs, or timing. We agree that Ofgem should be able to re-open the price control under defined circumstances.

The re-opener approach proposed by Ofgem appears appropriate for this purpose and provides an appropriate balance to address the risks faced by both companies and consumers.

**Response to RIO-ED2 Methodology Consultation**

**Increasing competition**

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

We welcome the fact that the sector methodology seeks to introduce new forms of competition that could facilitate new entrants, drive innovation, and introduce new solutions and technologies. In this regard, we agree the price control should continue to enable and incentivise competitions for:

- efficient DNO procurement of equipment and services (native competition), incentivised through the totex mechanism.
- procurement of non-network solutions through flexibility service tenders.
- competition between DNOs and IDNOs for new connections.

While enabling flexibility between network and non-network solutions is welcome, a key issue will be how decisions are made to choose between asset and non-asset solutions, and the ex-post assessments about whether the expected benefits were realised. We suggest that suitable reporting mechanisms are established so that the benefits can be assessed over time. We agree that it should be beneficial to increase competition further through the addition of early or late competitions for investment projects.

*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?*

Yes, in theory the DSOs should be best placed to assess network v non-network solutions, but they may not be best placed to take a 'whole system' view of potential options. The lack of independence of DSOs from their parent companies, and the commercial interests of DNOs may lead to concerns that competing solutions may not be chosen. This may restrict competition.

These conflicts will need to be addressed if DSOs are to run early competitions. It will be more appropriate for an independent third-party organisation to run these competitions, perhaps similar to the way in which the ESO runs the capacity market tenders.

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

We agree that all options, be it provision of generation, networks, storage, or demand response should be explored through transparent competitive processes. For this to be successful, the list of potential opportunities, the bidding requirements, the terms of contract, and evaluation criteria will need to be transparent and fairly applied. Bidders will want to have a reasonable chance of being successful and not face significant costs for multiple unsuccessful bids or cancelled tenders.

Early competition projects have the benefit that they can allow bidders to develop different solutions at a design stage, potentially bringing greater benefits. While early competition projects have proven difficult for electricity transmission because of the long planning and construction lead times for projects, this may not be the case for distribution networks and there may be greater opportunities as a result.

*COQ44: Do you have any views on our draft RIO-ED2 Late Competition Impact Assessment?*

We agree that the late competition model should not bring any additional material tender or financing costs.

## RIO-2 Challenge Group

### Response to RIO-ED2 Methodology Consultation

*COQ45: What are your initial views on the three models of late competition (CATO/CADO, SPV and CPM) in the context of electricity distribution? If there would need to be differences from the other sectors, can you please explain what these should be, and why.*

We think the CADO/CATO model offers the best opportunity for realising the benefits from competition as it requires bidders to offer solution with the widest possible scope and potential for innovation - covering equipment design, procurement, financing, construction, and operation. The tender process is run independently of the DNO, thereby eliminating potential conflicts.

The SPV and CPM models each reduce the scope of the potential competitive solutions and appear likely to reveal lower benefits.

*COQ46: Do you agree that the late competition models proposed could deliver benefits in RIO-ED2?*

Yes, we think increased competition could deliver benefits in RIO-2, and particularly the CADO model could be developed to extend from the competition in connections currently provided by ICPs and IDNOs. These already competing companies have the capabilities in place to offer such services.

*COQ47: Do you agree that our proposed criteria for identifying projects suitable for late model competition are applicable in the context of electricity distribution?*

We agree that the projects should be new, separable, and above a value threshold. We think that the threshold for competition could potentially be significantly lower than the £100m proposed for transmission, and closer to the project sizes that are currently targeted by IDNO/ICP developers.

*COQ48: What are your views on the best ways to identify a suitable project pipeline for late competition in electricity distribution (e.g. our proposal to require flagging of projects that meet the high-value, new, and separable criteria)?*

Yes, we think these projects should be flagged in the DNO plans but given that DNOs may be incentivised to package projects so they don't meet these criteria, there should be an independent review by Ofgem of their submissions.

*COQ49: Do you agree with the proposed range of options available for repackaging projects in RIO-ED2 in order to maximise consumer benefit?*

Yes, we agree that it makes sense to bundle, split, re-scope projects so that a pipeline of potential projects for competition can be identified. The projects should be sized in order to attract developers and investors willing to agree lower revenues than would otherwise be paid to the incumbent DNO.

*COQ50: What relevant factors do you think we should consider in deciding how these repackaging proposals are specifically applied in electricity distribution?*

We think this should be based on the views of potential bidders and investors for projects or packages of projects. The current suggestion for bundling of projects at £100m plus is targeted at investors seeking a larger investment size, whereas equivalent cost capital for a smaller portfolio of projects may be equally available.

### Incentivising business plans and their delivery

*COQ51: Do you agree with our proposed approach to implementing the CDIR method in setting the TIM efficiency incentive rate?*

## **RIO-2 Challenge Group**

### **Response to RIO-ED2 Methodology Consultation**

We welcome Ofgem's approach to the Confidence Dependent Incentive Rate that seeks to incentivise cost allowances to be evidenced by information that is independent of company forecasts. We agree that such evidence should include RIO-1 actual cost run-rates, competitive procurement, independent benchmarking or other suitable evidence.

Ofgem's proposal is that high confidence costs should have a 50% TIM efficiency incentive rate and that low confidence costs should have a 15% incentive rate. This recognises that it is very unlikely that all costs will be classified as low confidence, so this lower level is unlikely to be approached.

Given the experience in RIO-ET2/GD2, where a number of companies provided weak justifications for their expenditure, we suggest that Ofgem considers whether to sharpen this incentive, perhaps by reducing the lower incentive rate to 0% so that companies would be incentivised to provide stronger evidence to justify their plans.

*COQ52: Do you agree with our proposed design of the BPI for RIO-ED2?*

*And COQ53: What are your views on our suggestion to use proposals contained in draft business plans in the setting of baseline standards in a number of areas (as discussed in paragraphs 13.28 and 13.29)?*

*And COQ54: Do you agree with our proposal to cap the number and value of CVP proposals that can be included within business plans*

Overall, we think the structure of the BPI in this methodology is an improvement on the original version used to incentivise RIO-2 plans in other sectors. However, we still have concerns about whether the Consumer Value Proposition will prove effective in practice.

#### **Stage 1**

We have welcomed proposals elsewhere in the ED methodology to introduce minimum standards in a number of areas (to guide the creation and upgrading of consumer vulnerability strategies, for example). We also welcome the inclusion of an assessment of strategies against these baseline standards as part of stage 1 of the Business Plan Incentive. We think this should have the effect of adding relevant and specific detail to business plans and should generally raise the bar for what are regarded as minimum performance standards across the sector.

We recognise that stakeholder engagement will be assessed as part of Stage 1 of the BPI, and that the 'minimum requirements' bar here is high. It is particularly important that DNOs carry out extensive, systematic and high-quality stakeholder engagement to inform their forecasts and scenarios, given how central these are to their plans and to Ofgem's decisions. To reinforce this, we suggest that Ofgem sets out clear expectations for stakeholder engagement in this area in its methodology and guidance.

We would also strongly urge Ofgem to be explicit in its guidance that, at stage 1 of the assessment, an incomplete first draft is not acceptable and could be subject to a penalty. Without complete plans (at both draft and final stage), Ofgem's process is not as efficient or effective as it might be, and the Challenge Group cannot carry out the role that Ofgem has asked of it as fully or as well as is required by our Terms of Reference. Consumers and customers may be worse served as a result.

#### **Stage 2**

## **RIO-2 Challenge Group**

### **Response to RIO-ED2 Methodology Consultation**

We tentatively welcome the revisions to the design of the Consumer Value Proposition (CVP) concept which we think has more potential than the version used for other network sectors.

The opportunity for companies to receive a CVP reward if their strategies in key areas reveal higher standards that could be applied across the sector has merit. We also welcome the proposal to limit CVP proposals to five (albeit wide) priority areas, and we agree with the areas outlined (DSO activities, services to vulnerable consumers, services to large connection customers, Environmental Action Plans and whole system approaches).

However, we anticipate that the identification of 'higher' standards will remain a challenge in practice. Ofgem's definition of baseline standards in several areas will help. But, of course, a CVP reward is intended not to reward service that is better than the minimum, but standards that are significantly better than those already adopted as 'business as usual' in parts of the sector. Identifying those business as usual standards in a robust way that ensures that only genuinely new, higher standards are rewarded under the CVP incentive will not be straightforward. The CEGs, with their detailed understanding of company activities, may collectively be able to help here.

Ofgem also proposes that there are upper and lower value limits for CVP ideas (£3m and £10m respectively) as well as a maximum total number of proposals of 10 per plan with a maximum total aggregate value of £50m. We support the principle of guiding company behaviours here (based on the experience of companies' response in other sectors) but we think that simpler guidance may be more effective. This could retain the limit of c10 ideas per plan, perhaps in combination with a maximum aggregate cost rather than a maximum aggregate monetised consumer value. Companies should still, of course, still be required to identify and quantify the benefits to consumers of their ideas, and in monetary terms wherever possible. But this will not always be possible, and the lack of an effective monetary quantification tool may rule out some proposals that may bring useful benefits for consumers. We suggest that Ofgem also clarifies how the common Social Return on Investment methodology that is being developed by the DNOs could be used to demonstrate the value of CVP proposals.

There are also timing challenges which the methodology acknowledges to some extent. For this CVP process to work effectively to drive sector-wide improvements, we think that Ofgem should review CVP proposals in the July draft. This allows any successful ideas to be identified and rolled out to all DNOs to include in their final plans. However, given that CVPs are, by design, an enhancement on minimum requirements and 'business as usual' standards, this may also mean that Ofgem has to carry out its stage 1 BPI assessment in July. This could have the merit of very clearly incentivising the companies to submit complete and finished draft plans in July. However, if Ofgem expects these proposals to be informed by challenge from the company CEGs and, in particular, from the Challenge Group, it would have to require companies to present early drafts to these challenge groups before July. This is a concept which has so far been ruled out for ED. To avoid the reintroduction of a second draft plan, it may be more practical for only the CEGs to challenge the CVP proposals and their related plans in advance of July (to ensure that they are coherent and built on robust stakeholder engagement, for example), and for the Challenge Group to limit itself to an assessment of the proposals in July. This work could then inform Ofgem's own assessment of these parts of the July plans rather than being intended to influence the companies' own thinking.

### **Stage 3 and Stage 4**

## RIO-2 Challenge Group

### Response to RIO-ED2 Methodology Consultation

It is important that companies are incentivised to present well-justified costs. We think the incentive regime which applies to both high- and low-confidence cost areas is appropriate.

The reward and penalty are capped at 2% of allowed totex – we suggest that Ofgem should consider extending this range to increase the incentives for companies to submit well-justified, efficient costs

*COQ55: Is there any further detail on the proposed content of the Business Plans that you think should be set out in the Business Plan Guidance?*

We welcome the publication of the draft business plan guidance and Ofgem's request that companies should carry out robust and high-quality engagement with their stakeholders, including the Challenge Group and their CEGs.

We see our engagement with the companies during the preparation of their business plans as being critically important and this guidance should clearly set out the information that must be provided to us as well as Ofgem.

We are seeking that the information we receive from the companies is comprehensive, consistent with current RIO-1 reporting, and subject to clear change control and explanation. The draft plans should be as complete as possible, allowing sufficient time for our comments to be taken into account prior to final plan submissions and Ofgem's own assessment process.

We welcome that the guidance asks for information on DNO RIO-1 track records, explaining differences from the final business plans, together with plans for ongoing stakeholder engagement. We suggest that, in their final plan, the companies should also be required to explain how they have taken account of our comments on their draft RIO-2 plans.

Experience from the ET/GD price controls showed that it was difficult to assess and compare company proposals for bespoke outputs, targets and incentives, especially whether such costs were included in baseline expenditure or not. This is an important area, and we welcome proposals for additional guidance to ensure that this information is more easily accessible and comparable.

Where bespoke uncertainty mechanisms are proposed, the supporting evidence justifying their probability and impact should also be provided.

Quantitative data provided in the business plan submissions should be easily reconcilable to ongoing RIO-1 RIGs data (and associated Ofgem/company performance reports), and the submitted Business Plan data tables.

*COQ56: Is there other information that we should be requesting in the Business Plan Guidance in order to assess a network company's Business Plan?*

Please see our comments to the question, above.

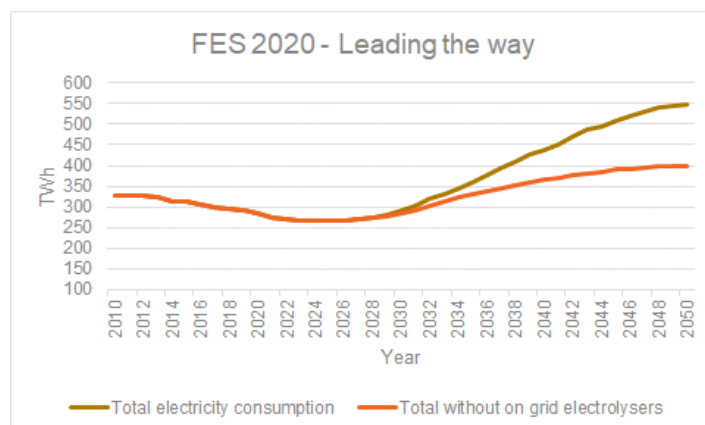
**Connections** - We would welcome an update on the new connection status for each DNO, identifying historical progress and offer pipelines. This should include progress being made in competition for connections for each DNO, including the numbers of connection offers by voltage and the market shares of each DNO/third parties.

**Future Scenarios and forecasts** - The guidance asks for DNOs to explain how they will apply distribution Future Energy Scenarios, including how this will be used to create a 'central view' whole network forecast. While we welcome this approach, we are concerned that this bottom-up approach will not be consistent with national or whole electricity system scenarios such as those set out in the recent ESO FES 2020 reports. We suggest that the guidance should require DNOs to

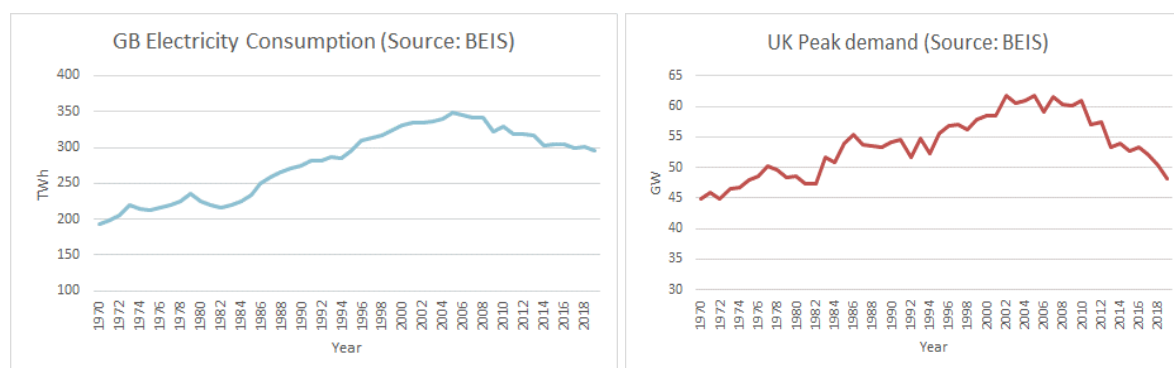
## Response to RIIO-ED2 Methodology Consultation

develop jointly assumptions and scenarios which are consistent with whole electricity system scenarios such as those in the FES.

For example, the following chart shows the FES 'Leading the Way'<sup>16</sup> scenario which envisages a high electricity future. It illustrates that electricity consumption without on-grid electrolysis (which are likely to be transmission connected and not impact the distribution networks) may not reach previous peak levels until the late 2030s.



**Historic utilisation data** – in justifying new investment, the business plan guidance asks for information on current levels of network utilisation and potential future changes. We welcome this approach but again would request that (for each DNO) actual data should reconcile to a consistent national approach as illustrated by the following charts of BEIS data<sup>17</sup> for peak and energy demands in the UK/GB power system.



*COQ57: Do you agree with the proposed set of minimum requirements for Stage 1 of the BPI that are set out in the draft Business Plan Guidance?*

Yes, we think these are appropriate minimum requirements. We would suggest that an additional item is added so Ofgem may specifically consider the views of the Challenge Group on the draft business plan. We think this should incentivise the companies to produce higher quality draft plans.

<sup>16</sup> <https://www.nationalgrideso.com/future-energy/future-energy-scenarios/fes-2020-documents>

<sup>17</sup> <https://www.gov.uk/government/statistical-data-sets/historical-electricity-data>



## RIIO-2 Challenge Group

### Response to RIIO-ED2 Methodology Consultation

*COQ58: Do you agree with the approach for assessing companies CVP proposals that is set out in the draft Business Plan Guidance?*

See the answers to COQ52-54, above.

*COQ59: We anticipate that DNOs are investing in improving/creating data dictionaries and business information models that describe the data-driven aspects of DNO's overall business architecture. We anticipate there may be opportunities to take advantage of these investments to support the process of cross-referencing data used within RIIO-ED2 Business Plans. What are your views on this?*

This should be useful, and we look forward to seeing the results. However, we would not want to see the trialling of new approaches result in delays or incomplete plans.

## Annex 3: Finance

### Allowed return on debt

*FQ1: Do you agree with our proposal to use the iBoxx Utilities 10yr+ index rather than the indices used in RIIO-1?*

Although an index composed of companies which are as close a match for the DNOs as possible appears in principle to be desirable, we have concerns about the proposal to use the iBoxx GBP Utilities 10 yr+ index for two reasons: firstly because the lack of an explicit rating makes it difficult to assess whether it is compatible with target financial ratios which will be used in the financeability assessments, and secondly because it appears to give rise to a requirement for a 17 bps allowance for issuance costs which was not required in the context of the index previously used.

*FQ2: With reference to paragraph 2.8, do you have a view on what debt allowance calibration should be used for business plan working assumption purposes, and why?*

Our preferred solution would be based on notional assumptions which would remove the need for calibration and replace it with a cross check (as for the cost of equity assumption). The use of actual historic debt issuance costs results in a methodology which is based on a combination of notional indexed debt allowances and actual costs. This produces a debt allowance which is not, in practice, fully indexed especially when combined with a relatively short price control period and an expanded trailing average. We are also concerned that it is disproportionately detailed and complex. If there is to be calibration, we would prefer a method which is less conservative than that used for other RIIO-2 networks with risk symmetrically shared around a baseline between consumers and the companies.

We would also like to see companies encouraged to engage with consumers in relation to other issues relating to the notional company such as the optimal mix of debt maturities: for example, consumers may prefer to see shorter term debt and carry the risk of rising interest rates to the option of issuing longer term debt now, while rates are low, even if this increases interest costs in the short term. We believe that the intergenerational issues which arise from determinations of capitalisation rates and depreciation periods should also be part of this consultation exercise. We maintain the view which we expressed in relation to the other networks viz. that there is no reason why an appropriately constituted group of consumers cannot be successfully engaged in issues of this type assuming appropriate methodologies are used. Companies are obviously free to deviate

## RIO-2 Challenge Group

### Response to RIO-ED2 Methodology Consultation

from the arrangements for which the notional company provides, but we consider consumers should be consulted as to the arrangements which they will have to fund.

*FQ3: Do you have any evidence to suggest ED networks should or should not have a debt allowance that has a different calibration to GD&T networks?*

See answer to FQ2 but, if there is to be calibration, we favour the use of the GD & T networks calibration (preferably with a higher degree of symmetry around the baseline) on the basis that we can see no reason why systematic risk – and hence borrowing cost should be higher than for the GD & T networks. In fact, a good case can be made that systematic risk is lower for the ED networks. All networks potentially face higher levels of uncertainty in relation to strategic investment than in RIO-1. However for the DNOs that is likely to take the form of multiple small investments rather than a smaller number of larger (and therefore inherently riskier) investments and they are also very well protected by the proposed suite of uncertainty mechanisms and the overall regulatory framework. There is clearly some risk implicit in the requirement for investment in IT to support the splitting off of the DSOs: we think this can (and should) be dealt with by an appropriate incentive regime so that it does not impact on the required cost of capital allowances (see similar comments in answer to FQ7).

*FQ4: Do you have any views on our analysis of additional costs of borrowing that may not be captured by an index of bond yields?*

We consider the proposed 17bps allowance for issuance costs to be overly generous, especially as it would apply to existing embedded debt as well as future debt. The allowance of 17bps (which we note is rounded up from 16.5) is greatly influenced by the wide range on the estimated cost of carry. We would want to see good evidence that the upper end of that range is strongly supported by justifiable market data. We note that there is no evidence of the need for such an allowance in the context of the index used in RIO-1 (see also our response to FQ1).

*FQ5: Do you agree with our proposal to use the longest term OBR forecast for CPI to deflate nominal index yields to a real CPIH allowance and to switch to using OBR CPIH forecasts if these become available?* Yes – this is a practical compromise.

### Allowed return on equity

*FQ6: In light of the equity methodology we set out in Draft Determinations for GD&T, do you have a view on how implementation could best be applied to the ED sector?*

We agree with Ofgem's assessment that there is no compelling reason to adopt a different approach to that set out in the GD & T Draft Determination.

*FQ7: Do you have suggestions on how we could estimate systematic risk for ED2 or any evidence to support a difference between ED and the other RIO sectors, GD&T?*

The need to achieve Net Zero may imply higher levels of uncertainty – and hence additional risk – in relation to strategic investment than in RIO-1. For all networks, the risks and uncertainties are very substantially mitigated by the regulatory framework (and the support for the RAV which it provides) such that, overall, we consider the risks for all networks are lower than they were in RIO-1. Taking the key risks in turn:

- demand risk – to which none of the network companies is exposed

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- stranding risk – for all network companies, the cost of new assets is recovered through the RAV and depreciation allowances
- extreme events such as weather – mitigated for all network companies through the price control arrangements
- expenditure risk – mitigated for all companies through the price control arrangements
- change of law or policy (such as changes in tax rates or environmental standards) – substantially mitigated for all network companies through price control arrangements
- inflation – mitigated for all network companies through the price control arrangements.

We certainly do not consider that the residual risks are any greater for ED than for GD & T. In fact, a good case can be made that systematic risk is lower for the ED networks on account of:

- anticipatory investment allowances - although all networks face higher levels of uncertainty in relation to strategic investment than hitherto, Ofgem proposes that DNOs will be given strategic headroom in the load-related expenditure allowances which will mitigate the risk that such expenditure is excluded from allowances
- smaller scale projects – expenditure for the DNOs is likely to take the form of multiple small investments rather than a smaller number of larger (and therefore inherently riskier) projects
- competition for connections – competition by IDNOs for construction and ownership of connection assets means that the DNOs may not, in fact, be undertaking a significant proportion of the required connection expenditure, thereby reducing the risk to them
- DSO expenditure - there may be some risk implicit in the requirement for investment to support the splitting off of the DSOs (in, for example, IT) but we think this can (and should) be dealt with by an appropriate uncertainty mechanism.

### Financeability

*FQ8: Do you agree with our proposal to align the RIO-ED2 financeability approach with the approach we have taken for GD&T?*

We see no reason to use a different *approach*, as set out in Section 4.7 of the SSM Consultation i.e. a focus on the notional company with a detailed review following submission of business plans but we have expressed concern that the *application* of that approach in relation to GD & T is a draft determination which we regard as generous.

*FQ9: Are there any reasons why this approach should differ for RIO-ED2?*

As above, we see no reason to change the methodology but are anxious that it should produce a more nuanced approach to financeability than has been evidenced by the GD & T companies which we consider placed an excessive emphasis on AICR and PMICR and produced insufficient justification for their target ratings. We consider that this, coupled with a cautious approach to debt calibration, risks consumers paying more than necessary.

We would encourage Ofgem to consider whether it might be appropriate to incorporate in the evaluation of the BPI an assessment of the effectiveness of consumer engagement in relation to

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financeability. This applies particularly – but not only - in relation to the trade-off between gearing and cost of debt (see answer to FQ2).

*FQ10: Do you have a view, supported by evidence, regarding the appropriateness of different measures to address any financeability constraints?*

We consider all the five measures set out in Section 4.8 to be appropriate and that it should be made clear that companies will be expected to use any or all of them to achieve financeability at the lowest cost to the consumer.

*FQ11: Do you have any views on the proposed scenarios to be run for stress testing?*

We agree with Ofgem that there are no significant sector specific differences which would make it appropriate to run stress test scenarios different from those used for GD & T.

We stress, however, that we consider it essential that scenarios are established at an early stage and that both they and the financial parameters of the notional company are clearly established (and incorporated into Ofgem's financial model) in time to ensure that companies are able to submit plans in July which, even if not final, are very well developed.

### Financial resilience

*FQ12: Do you agree with our proposal to place additional requirements on licensees in RIO-ED2 to provide Ofgem with a) published ratings reports, and b) a financial resilience report if their issuer credit rating falls below specified levels?*

Yes.

### Corporation tax

*FQ13: Do you agree with our proposal to align the RIO-ED2 tax approach with RIO GD&T including; to pursue Option A; the approach to additional protections; the approach to capital allowances; and not to pursue the Fair Tax Mark certification as a requirement for RIO-2?*

We agree with Ofgem that it is appropriate that companies should be largely, though not entirely, protected from tax risk so that they are incentivised to optimise their tax position. However, we think that can be achieved with the 'double lock' option or at least that tax outperformance under Option A should be shared with the consumer in the same way as totex outperformance.

We expressed support for the additional protections proposed for GD & T and see no reason to adopt a different stance in relation to ED2.

We are not in a position to comment in detail on the proposals in relation to capital allowances.

We agree that it is not necessary to require companies to achieve the Fair Tax Mark.

*FQ14: Are there any reasons why this approach should differ for RIO-ED2?*

As above, we can see no reason for a different approach.

### Indexation of the RAV and allowed return

*FQ15: Do you agree with our proposal to implement CPIH inflation?*

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Yes, in the absence of a more appropriate alternative to RPI. We also agree that it should be introduced at the start of the control period.

*FQ16: Are there any reasons why this approach should differ for RIO-ED2?*

We can see no sector specific issues which would indicate a requirement for a different approach.

### Regulatory depreciation

*FQ17: Do you have any specific views or evidence relating to useful economic lives of ED network assets that may impact the assessment of appropriate depreciation rates?*

We, of course, support the concept that depreciation rates should be reflective of the useful economic lives of the relevant assets. It also seems to us that developments in the sector are such that a longer period (constrained by expected asset lives) may be appropriate. We would like to see provisions which encourage companies to use (small) amendments to depreciation periods to improve financeability ratios.

*FQ18: During RIO-ED1, the assumed asset life is being increased. Do you consider another change is required in RIO-ED2 to reflect the expected economic asset life? If so, do you have supporting evidence and proposals at this stage?*

See answer to FQ2: we would like companies to be encouraged to engage with consumers as to the most appropriate assumption for asset lives from an intergenerational perspective including consideration of (small) adjustments which would reduce overall financing costs for consumers.

### Capitalisation rate

*FQ19: Do stakeholders support licensee specific rates for the ED sector?*

Yes, we share Ofgem's view that capitalisation rates should reflect the proportion of opex and capex in each licensee's totex. We would like to see provisions which encourage companies to make (small) changes to capitalisation rates to improve financeability ratios.

*FQ20: For one or more aggregations of totex, should we update rates ex-post to reflect reported outturn proportions for capex and opex?*

As in GD & T, there are considerable uncertainties surrounding the eventual levels of totex (particularly capex) in the ED sector. Against that background, we consider a good case can be made for reviewing capitalisation rates ex post.

### Directly remunerated services

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

We see no reason why the approach should differ.

### Disposal of assets

*FQ22: Do you support our proposal to continue the RIO-ED1 approach to disposal of assets for RIO-ED2?*

We see no reason why they approach should differ.

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**Dividend policy**

*FQ23: Do you agree that additional reporting on executive pay/remuneration and dividend policies will help to improve the legitimacy and transparency of a company's performance under the price control?*

As with GD & T (and Ofwat in relation to water) we agree with the proposals for additional reporting on executive remuneration and dividend policies, and that such legitimacy and transparency are important in this context.

**Return adjustment mechanism**

*FQ24: Do you agree with our proposal to introduce a symmetrical RAMs mechanism?*

If there is to be a RAM mechanism, we agree that it should be symmetrical (but see answer to FQ26 below).

*FQ25: Do you agree with our proposal to introduce a single RAM threshold level of 300 basis points either side of the baseline allowed return on equity?*

We consider 300 bps the minimum appropriate threshold.

*FQ26: Do you have any other comments on our proposals for RAMs in RIIO-ED2?*

We had reservations about the RAM mechanism in relation to GD & T and have similar reservations in relation to ED: it effectively transfers risk from the licensee to the consumer. However we can see no argument for a difference in approach between GD & T and ED and therefore comment only that, if there is to be a RAM mechanism, it is important that the lowering of the licensee's risk profile which it implies is reflected in the cost of equity allowance.