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Dear Akshay,

## **RIIO-2 ED2 Methodology – WWU response**

We welcome the opportunity to provide our views on the RIIO-2 ED2 Methodology issued on 30<sup>th</sup> July 2020.

Our responses provided in this document build on responses to the RIIO-2 Draft Determinations response issued on 9<sup>th</sup> July, which we responded to on the 4<sup>th</sup> September.

We have responded by following the structure of the Ofgem consultation documents, clearly marking the consultation question or paragraph number which relates to our response. I can confirm that our response is not confidential. Should you have any queries on our responses please do not hesitate to contact me.

Yours sincerely



Sarah Williams  
Director of Regulation

# RIIO-ED2 Methodology Consultation: Overview

## 4. Net Zero and Innovation

### Net Zero re-opener

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

We note that while “input from stakeholders is vital in allowing the proposed mechanism to work” that Ofgem is reserving to itself the power to trigger this re-opener mechanism. We think that networks must be allowed to formally request that this re-opener is triggered. Without any formal process for deciding whether this re-opener is triggered it runs the risk of not responding to the needs of companies and their consumers.

We recognise that Ofgem needs to protect the interests of consumers and not allow expenditure that is not cost effective; however, networks will not make a return from Net Zero projects funded by the Net Zero uncertainty mechanism. This means that if there is a risk that they will incur costs that are subsequently not recoverable it will make such projects financially unviable.

There clearly needs to be a balance between networks bearing all the risk which may result in very few projects being delivered which will threaten the delivery of the UK Net Zero target and measures to protect consumers from expenditure that is not cost effective in moving toward Net Zero.

In our view this would be achieved by: -

- 1) Zero thresholds;
- 2) Networks should be allowed to trigger the Net Zero re-opener in addition to Ofgem;
- 3) There should be Annual application windows to provide a flexible and agile approach;
- 4) The triggers should relate to achieving Net Zero in a cost-effective way over an appropriate lifetime;
- 5) The application process and assessment criteria need to be clearly and unambiguously defined ahead of the start of the RIIO 2 price control period so that networks can clearly see what evidence of efficiently incurred costs and benefit is required when they make applications for completed projects;

- 6) The application will be prospective for proposed projects. It will enable costs to be claimed both for those involved in preliminary work to establish the project as well as those expected to be incurred during the project. The network would agree to deliver the projects for the stated sum by the stated date and deliver the stated benefit with any underspend or overspend would be subject to Totex sharing. This would provide a clear incentive for the network to propose well designed and deliverable projects; and
- 7) If a zero threshold is not provided, then projects that did not meet the threshold would be eligible for the aggregation mechanism (please see our answer to Core Question 12 on the need for a lower aggregation threshold).

## **Strategic Investment for Net Zero**

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

The current circumstances, i.e. the clear national policy on power and transport give a strong impetus to a centralised approach. Whilst heat is less clear, a centralised view would protect consumers from unnecessary investment until clearer policy emerges. A centralised forecast, based on National Grid's FES Steady Progression would be the most useful form. The NG FES Steady Progression accounts for the latest government policy and the changes to the energy system that are most likely to happen. Beyond that, changes are highly speculative and mostly based on local opinion rather than evidence. In addition, local targets are being proved to be unrealistic and often not the cost optimal route for consumers. Following a regional approach is likely to result in higher costs for the consumer.

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

The key factors are those related to taking the broadest whole energy system into account. This goes well beyond the local and regional choices for heat, power and transport, but upstream to the source of the energy supply. The key factors are the reliability of the generation source, for example wind vs. solar; their reliability through the seasons and their generation/load factor. In addition, the availability of seasonal flexibility, storage and interconnection. A centralised approach would narrow the range of these factors to produce a national supply 'envelope'. Investment outside that 'envelope' would require detailed justification how consumers would be better off, both financially and from a security of supply perspective.

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

In some areas, a highly regional approach may be appropriate, for example if a local area had an all season, reliable energy supply that may require local investment alone, and not rely on duplicate 'out of region' back up. For example, energy supply derived from a large water body, such as a water sourced heat pump or tidal lagoon would require supporting investment outside the national supply 'envelope' described in question OVQ 5. Investment to support such a project would be ideally suited to the Net Zero uncertainty mechanism, subject to the observations made in response to OVQ 3.

**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?**

Many decentralised approaches are highly ambitious and lack detail of the key metrics to enable them – source of the renewable/low carbon energy; local investment needed both by consumers and infrastructure providers; committed funding to enable all three. Hence these would be useful factors to provide high degree of certainty. Without that, the Net Zero uncertainty mechanism would be a better vehicle for funding.

**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 LEAP guidance provides a foundation for local planning and provides an excellent starting point for the parameters around technical models; engagement of interested parties and a multi vector approach. However, based on the document referenced, it appeared not to recognise a local plan as part of a whole energy system – notably the cost and reliability of the energy supply. It is noted the two recommended models have been used previously, but didn't reference that a whole system had been accounted for or what assumptions had been made related to the carbon content of supply, its cost and its reliability. Without detailed reference to the upstream implications of such derived recommendations, a cost optimal secure solution cannot be obtained.

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

Subject to the improvements detailed in answer to OVQ3, the Net Zero mechanism would be best suited to Net Zero investment.

## 7. A whole system approach

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

The main barrier to whole system solutions is understanding the broad nature of whole systems. As the energy system has increasingly become interconnected, for example, the electricity distribution system to the gas distribution system, every solution has a knock-on effect to another part of the energy system. The whole energy system should at least consider:

- All vectors of demand – Heat; power and transport
- All vectors of supply – renewable/low carbon power; green gases; renewable heat, such as geothermal.
- All elements of the energy supply chain – generation; interconnection; transmission; storage (seasonal/medium and short term); distribution and consumer uses (Appliance type; transport mode)
- Supply and demand profiles of the above at sufficiently high definition.
- The key price control mechanism noted to date is the CAM. In addition, investment should be conditional on adopting a broad whole systems approach as detailed above.

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

Whole system solutions, that include all vectors and all parts of the energy supply chain are essential to keeping the cost to the consumer at the lowest possible level and providing reliability. Hence whole energy system engineering is very relevant to the innovation stimulus. Innovation ideas should be able to demonstrate their position with the broadest whole system definition, to ensure unintended consequences such as higher generation, flexibility or storage costs.

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

We support the materiality threshold on the CAM re-opener being zero, given the unknown possibilities in this area and not understanding the potential costs on DNOs and transmission.

We believe a financial incentive should be encouraged to ensure joint working, best possible customer outcomes and least cost solutions, especially if the costs will not be subject to TIM. The foreseeable criterion is flawed on the basis not all price controls are aligned so investments can only be assessed on a regulatory cycle for that industry. The trigger should come from both companies in agreement only.

Given the number and value of uncertainty mechanisms now included in the price control, we would propose an annual window. Ideally the re-opener window would be May each year so the revenue can be adjusted in the annual AIP in November each year, but given annual regulatory reporting and the level of significant evidencing required January would be a suitable month, this enables time following the end of the regulatory year to access and provide relevant information to support the uncertainty claim. Given CAMs cuts across different industries there is an impact on time sensitivity and different regulatory priorities, further supporting the annual window.

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

We would recommend that the electricity licences are amended now in order to support flexibility and cooperative working before the start of their price control in 2023, if not, the CAM mechanism will not be used until at least 2023.