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CFU response to the RIIO 2 Framework Consultation

The Consumer Futures Unit (CFU), part of Citizens Advice Scotland, uses research and evidence to put consumers at the heart of policy and regulation in the energy, post and water sectors in Scotland. We work with government, regulators and business to put consumers first, designing policy and practice around their needs and aspirations.

Under our statutory remit, we are the advocate for Scottish consumers on energy network issues. Although we are separately funded organisations, we work closely with colleagues in Citizens Advice England and Wales in this area. Our response below focusses on Scottish specific points which we believe are important considerations for the RIIO 2 framework. We have not responded to questions on topics such as financeability and fair returns, as this is covered by the response to be submitted by our colleagues in Citizens Advice England and Wales.

We believe that the transition towards a smarter, more flexible and greener energy system is arguably happening faster in Scotland and therefore the way in which network companies operate differs increasingly compared with England and Wales. We are soon to publish research undertaken by the Centre for Sustainable Energy, which explores how DNOs currently support consumers in Scotland under RIIO 1 and what best practice can be taken forward into RIIO 2. The research involved interviewing policy and industry experts to gain insight on what they consider to be Scottish-specific network issues. Some of the conclusions

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highlighted a number of Scottish specific characteristics that we think should be reflected in forthcoming energy networks regulation. These are listed below and expanded upon in our response to question 49:

- The numbers of island and remote rural communities - which may need smart energy system solutions involving domestic consumers sooner than other places to address network constraints
- The number of community energy initiatives (raising issues of the adequacy of consumer protection)
- The high penetration of on-shore wind power which can create localised network challenges.
- The high proportion of homes not connected to the gas network, relying on electricity for heat (mainly in storage heaters).
- The higher levels or fuel poverty and energy market disengagement in Scotland.

As the research points out, these particular characteristics need to be reflected in policy and regulation at a UK level, such as in the RIIO 2 framework. The framework must be designed with the principle of fairness at its heart, and ensure that vulnerable consumers in Scotland, and in the rest of GB, are not disadvantaged.

A number of key considerations that we believe Ofgem should consider whilst designing the RIIO 2 framework are:

- Ensuring that 'no one gets left behind' in the transition to a smarter electricity network in Scotland
- The need for consumer protections within community energy projects and for new flexibility services
- The need for whole system planning with integration of local heat and energy efficiency strategies
- The need for debate on the future of the Fuel Poverty Network Extension Scheme in Scotland
- Ensuring that confidence amongst network companies remains high in the RIIO –ED1 SECV Incentive scheme so that it serves the intended purpose of being truly 'incentivising'
- Given the risks of disconnection on vulnerable consumers, reliability of supply to all Scottish consumers must remain a priority

Scottish consumer characteristics must also be centrally recognised in other Ofgem work programmes, such as the Targeted Charging Review, where any changes to charging structures could have a high impact on certain Scottish consumers with high electricity use – due to a reliance on electric heating, climate-related high energy demand and energy inefficient building stock.

Please find our responses to the consultation below. We have answered those questions that are relevant to our remit as representatives of Scottish energy consumer interests; these are questions 1, 10, 13, 31 and 49 in the consultation.

STAKEHOLDER ENGAGEMENT

Q1. How can we enhance these models and strengthen the role of stakeholders in providing input and challenge to company plans.

1. As stated in Ofgem's 2018/19 work plan consultation document, the RIIO programme is designed to ensure that network companies deliver outputs that customers need and value. We are encouraged to see Ofgem's intentions to put consumer engagement at the very heart of the RIIO 2 price controls. As noted below, we believe that further consumer engagement, scrutiny and challenge can bring positive outcomes for consumers and network companies if undertaken appropriately and transparently.

2. As we have discussed with Ofgem representatives on the 28th of March, we have experience and knowledge in this area, having played a pivotal role in the establishment of the Customer Forum in the Scottish water industry. There are a number of parallels between the Customer Forum and Ofgem's proposed RIIO2 Consumer Challenge Group, the lessons from which could be relevant in scrutinising the business plans of energy networks.

3. To give some context, the Customer Forum in the water industry in Scotland has a central role in the Strategic Review of Charges (the equivalent of RIIO), charged with representing consumers' needs and priorities in the development of Scottish Water's Business Plan. Established in partnership by the Water Industry Commission for Scotland (WICS), Scottish Water, and ourselves as the consumer advocacy body, the Customer Forum is in practice an expert challenge group. Contrary to what is stated in the RIIO 2 framework consultation, the Customer Forum is not based on a pure negotiated settlement approach, with WICS retaining the final decision making power over business plan approval.

4. The Forum's role is significant and active, requiring the forum members to work closely with Scottish Water, and other stakeholders (including the CFU), over a two- to three-year period. In essence, it is about balancing charges to consumers with the costs of infrastructure management, innovation, investment and maintenance and therefore has many parallels with decisions being taken by energy network

companies.[1] As the present role of the OECD in evaluating the process demonstrates, the customer forum model is seen to be innovative and world leading[2].

5. In 2016 the CFU commissioned Involve and Ipsos Mori to undertake a meta-analysis and scoping exercise of public participation in the regulated industries[3]. The analysis focussed on the use of deliberative research methods and involved desk based research, outreach to stakeholders and qualitative in-depth interviews. The research findings were used to assess what methods are most appropriate for engaging with consumers, and the wider public, on strategic policy issues within the specific context of the regulated industries. The Scottish Water Customer Forum was used as one of the case studies and a member of the forum took part in an in-depth interview. Below a number of lessons from the Customer Forum that may be transferable to customer engagement methods proposed in the RIIO 2 consultation are noted below.

6. **Lessons from the Customer Forum:**

- The Forum was able to integrate a customer perspective into the planning of a monopoly supplier.

- The Chair of the Forum placed particular value on research that was carried out by the Forum directly, as primary consumer research added credibility to the views of the Forum.

- Setting up challenge groups should happen as early as possible to enable members to gain a thorough understanding of the sector.

- There is a risk that challenge groups may become 'expert' over time if their membership is not regularly renewed. It was acknowledged in the research that Forum members' questions may have become less challenging as they developed a wider and deeper understanding of the industry context, and became more accepting of the reasoning and arguments put before them. This however has to be balanced with the fact that, as their knowledge increased, they were also able to focus their points of challenge effectively on those areas that they were least satisfied with. For these reasons, when the

[1] https://www.eprg.group.cam.ac.uk/the-customer-forum-customer-engagement-in-the-scottish-water-sector/
[2] https://www.oecd.org/governance/observatory-public-sector-innovation/innovations/page/customerengagementinsettingwaterpricesandinvestmentprioritiesinscotland.htm
[3]https://www.cas.org.uk/system/files/publications/meta-analysis_and_scoping_exercise_into_public_participation_in_the_regulated_industries_ipsos_mori_involve_-_2017-10-12.pdf

second Customer Forum was established in 2017 a deliberate decision was taken to have a mix of new and previous members.

- The research identified the importance of engagement and involvement of senior management in the Forum process. The Chair noted that the support of the CEO of Scottish Water in the Forum process, set a tone within the company that ensured that the Forum's input was treated as valuable.

- During the current Strategic Review of Scottish Water, there has been a planned process for key stakeholders such as Citizens Advice Scotland, the Scottish Environmental Protection Agency and the Drinking Water Quality Regulator to support the Customer Forum and Scottish Water. This co-operation by key organisations is helping foster shared strategic purpose and objectives, as well as joint working by all the key partners in the water industry in Scotland.

- A lack of dedicated resources proved somewhat limiting for the Forum, and considerably more responsibility was put on the Chair than anticipated.

- During the current Strategic Review of Charges process for Scottish Water, a planned process is underway involving key water industry stakeholders such as Citizens Advice Scotland, the Scottish Environmental Protection Agency and the Drinking Water Quality Regulator to support the Customer Forum and Scottish Water. This co-operation, led by WICS, is helping to clarify shared strategic purpose and objectives, and foster stronger joint working between all the key partners in the water industry in Scotland.

- Another key lesson from the Forum which could be applied to RIIO 2 by Ofgem is the use of a 'Research Coordination Group'. The purpose of this in the Customer Forum's case is to identify gaps in consumer research between Scottish Water, the CFU and WICS which can be used to, for example, cross-examine an investment decision in a business plan. This type of model could potentially be used by Ofgem to coordinate the various strands of consumer insight research that network companies, consumer bodies such as Citizens Advice Scotland and Ofgem already undertake, and build a more coherent picture of what consumers think and want in regard to networks.

- We would welcome the opportunity to discuss our insights further with Ofgem and we would be happy to put relevant staff in touch with the relevant people in the Customer Forum.

Costs

7. Although no formal value for money study was conducted for the Customer Forum, the costs are regarded to be minimal, relative to the impact the Forum was perceived to have delivered. We believe that given the high capital investment requirements associated with maintaining and upgrading an energy network, the cost of setting up and running challenge groups will be insignificant relative to the potential benefits brought to consumers. However we stress that challenge groups must be: sufficiently resourced, assign the correct personnel and have sufficient time to properly scrutinise plans to ensure that the process is successful.

True Influence

8. As was noted in the RIIO2 Enhanced Stakeholder Engagement Guidance notes, we believe it is important that engagement groups highlight areas of agreement and disagreement and importantly should be able to evidence how the company has responded to challenges that have been raised through the process. As the RIIO 2 consultation document highlights, it is this level of scrutiny that we feel is missing from stakeholder engagement processes under RIIO 1. As an organisation we attend many stakeholder panels but it can be unclear how our input is incorporated into how companies operate. At points it appears to merely be a 'tick-box' exercise in stakeholder engagement without any tangible demonstration of how it has influenced business plans.

9. Beyond having their business plans approved, we would like Ofgem to encourage companies to set up effective engagement groups that truly influence the way in which the network companies implement their business plans in the longer term. This is the route that WICS has taken in Scotland; to extend the role of the Customer Forum beyond the assessment of business plans and into the implementation phase.

Resourcing

10. As the consumer advocate in the energy industry in Scotland we are conscious that participation in the RIIO process, be that is consumer engagement groups or our ongoing membership on specialist stakeholder panels will be a significant demand on our resources. However we feel that it is essential that we are involved. This is something that we will need to be considered as groups are established in Scotland. Furthermore, if we are invited to sit on company led groups, then this has a significant resource implication. We anticipate that, given the tight timescales and limited number of consumer experts in Scotland, the process of recruiting consumer experts to network company user groups will likely be competitive, and it is important that

companies are supported by Ofgem in how to do this well to ensure consistency between all companies.

Other

11. It may also be of interest to you that in 2018 we plan to conduct deliberative consumer research to understand what Scottish consumers prioritise in relation to infrastructure investment and development of the energy networks and if/how attitudes where between different localities. As the consumer representative body in Scotland, this will help us to take an evidence-based approach while advocating for a wide range of Scottish consumers.

END USE ENERGY EFFICIENCY

Q10. In light of future challenges such as the decarbonisation of heat, what should be the role of network companies, including SOs, in encouraging a reduction in energy use by consumers in order to reduce future investment in energy networks.

12. Consumer research has shown that energy consumers have little awareness of the role of DNOs or how they work, with most presuming that electricity that flows to their homes is controlled by suppliers.[4] For this reason it's appropriate to question whether messaging around reducing energy use should come from network companies that are unfamiliar to consumers.

13. In Scotland a number of organisations such as the Energy Saving Trust, Resource Efficient Scotland and Smart Energy GB already provide impartial advice on reducing energy consumption and there is a risk that messaging around energy use becomes confusing to consumers if it is delivered by too many different organisations. Furthermore consumers may be sceptical of the motives of a profit-making company. If reducing consumption, through behaviour change, demand side response or energy efficiency is seen to be a credible alternative to network reinforcement it is likely that a large scale, well-resourced national campaign will be needed to support consumers through the required changes. If network constraint issues are forecast at a local level it may also be appropriate for local community groups to be at the centre of any consumer facing engagement[5].

14. In 2015 energy efficiency was designated as a National Infrastructure Priority by the Scottish Government. It is important that any work completed by network companies

[4] Based on findings from Ofgem's Consumer First Panel Year 4 - Consumer priorities for electricity distribution network operators, 2012.
[5] As was the case in the ACCESS project on the Isle of Mull - http://www.accessproject.org.uk/

in the energy efficiency sector in Scotland is aligned with Scotland's Energy Efficiency Programme – newly named Energy Efficient Scotland. Energy Efficient Scotland is a 15-20 year Scottish Government programme which is due to be launched in late 2018 with the aims of tackling fuel poverty and reducing greenhouse gas emissions[6]. Given the need for consumers to engage with Energy Efficient Scotland, especially in the owner occupier sector, where there is still a lot of work to be done to improve the energy efficiency of the building stock, there is a need for simple, clear, convincing and compelling messages around energy efficiency[7].

15. For non-domestic energy users (larger than SMEs) it may be more appropriate for an SO or a DNO, potentially through local partners or through a local authority, to contact businesses if there is a particular network constraint issue that would benefit from demand reduction.

INNOVATION

Q13. (iii) How can we enable third-party engagement and what could be the potential additional benefits and challenges of providing direct access to third parties in light of the future sources of transformative and disruptive innovation.

16. While the use of third parties has potential to facilitate the use of innovative solutions in the energy market, giving consumers direct access to third parties introduces a number of risks and challenges.

17. The CFU recently commissioned Purple Market Research to conduct research[8] to explore consumer protection in the Scottish and English water markets[9], with a particular focus on Third Party Intermediaries (TPIs).

18. The research reported that in the water sector, regulators, licenced providers and even TPIs themselves expressed concerns about consumer detriment resulting from the activities of TPIs that focus more on commercial gain rather than transparent services that meet consumers' needs.

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[6] The Scottish Government is due to announce the Energy Efficient Scotland routemap on 2 May 2018 which will provide details on how the programme is to be delivered by who and when.
[7]https://www.cas.org.uk/system/files/publications/cfu_submission_to_sg_consultation_on_seep_-_may_2017.pdf
[8] Yet to be published
[9] The non-domestic water market has been competitive in Scotland since April 2008, and in April 2017 the English non-domestic water market was also opened to competition, so that non-domestic consumers in both countries are now able to shop around for water and wastewater services, including through third party intermediaries (TPIs).

19. The research reported that in sectors such as the finance and legal services, the adoption of 'consumer principles' is considered the 'gold standard' and involve product or service suppliers taking responsibility for determining how best to meet their customers' needs (including protection), stating how those needs will be met, and demonstrating that this is being done. In 2018 the CFU published *Leading by Example: a principled journey through regulation*[10] in which 7 overarching Consumer Principles are set out and if adhered to, will ensure that markets are shaped around consumers. The seven principles are:

    - Information
    - Access
    - Choice
    - Redress
    - Safety
    - Fairness
    - Representation

20. However, due to the deregulated nature of the environment they are operating in, consumer protection is reliant on a willingness of any TPI or other service provider to adopt and adhere to any code of practice, such as the Consumer Principles, that is developed for them.

21. As in the water sector, Ofgem must ensure that consumers are not exposed to unacceptable levels of risk in a market where TPIs are a central component. Further views on the need for consumer protection in the electricity market are noted in our response to question 49.

ANNUAL REPORTS / REPORTING

Q31. How can we best improve the suite of annual reporting requirements to be as efficient and useful as possible?

15. While network company stakeholders currently have no formal role in assessing or reviewing network company business plans, annual reports are often presented at stakeholder panels and workshops. With limited time resource to review the plans in detail it would be useful if annual performance reviews:

[10] https://www.cas.org.uk/publications/leading-example-principled-journey-through-regulation

- Consistently reported KPIs and details of expenditure over a number of years to allow comparability[11].
- Consistently reported on the contribution to consumers bills with justification of any upturn compared to previous years.

SECTOR SPECIFIC ISSUES AND FACTORS TO CONSIDER

Q49. Are there any sector-specific issues or policy areas that we should ensure we review and consider as we develop our sector-specific proposals?

16. As previously mentioned, the CFU recently commissioned the Centre for Sustainable Energy[12] and Changeworks[13] to undertake research[14] which explores how DNOs currently support consumers in Scotland under RIIO 1. Using views sought while interviewing policy and industry experts, the report makes a number of recommendations around the future of the energy system under RIIO 2. Below a number of the key findings which may influence how sector specific proposals are shaped are detailed below.

Ensuring that no one gets left behind in the transition to a smarter electricity network.

17. The concept that 'no-one gets left behind' in the shift to a smarter electricity network is recognised as key consideration by most interested parties. Therefore the RIIO 2 framework should be designed to ensure that the principle of fairness is at the forefront of the price control and not solely a consideration.

18. As our research highlights the 'social licence' for network companies to operate is seen to be reliant on them delivering services that do not further isolate those in fuel poverty or in vulnerable situations. However, given DNOs (and DSOs hereafter as 'neutral market makers') may not be fully in control of what smart services are offered to whom at what prices, there are some considerable risks associated with any approach which does not embed the 'no-one gets left behind' principle from the beginning. Ofgem must ensure that consumer protection, in services offered by network companies or through TPIs, is treated as an essential component. As noted above this is essential for DNOs to maintain their social licence to operate.

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[11] Some performance reviews currently do this i.e. SSEN Transmission Performance Report but others do not i.e. SPEN Distribution Annual Report 2016/17
[12] https://www.cse.org.uk/
[13] https://www.changeworks.org.uk/
[14] Soon to be published research by CFU – Energy Networks in Scotland and consumers- undertaken by the Centre for Sustainable Energy.

19. The RIIO 2 framework needs to provide clarity on how the 'no-on gets left behind principle' is delivered in practice, and particularly in a Scottish context where there are particular challenges to the smart energy transition e.g. smart meter coverage, network constraint issues, high level of fuel poverty.

20. To realise this principle in practice, specific efforts will need to be made to enable more vulnerable households to participate in flexibility services and other 'value earning' smart energy activities. Our research[15] states that the costs of enabling such activities should be socialised across all consumers and will therefore need to be included in future regulatory settlements.

The need for consumer protections within community energy projects and for new flexibility services

21. With a strong interest in community energy and local energy planning in Scotland, from both community groups and the Scottish Government, there needs to be more consideration of how vulnerable consumers are protected within local energy projects, particularly where they involve supply relationships (such as local energy markets and peer-to-peer trading). The evidence available suggests community groups involved are not engaged with this issue.

22. The same consumer protection issues need considering in relation to providers of flexibility services where regulatory arrangements remain opaque. This is a GB-wide issue but may emerge earlier in Scotland as a result of the need for (or value of) flexibility within island and remote communities where network constraints exist, thus inevitably involving domestic consumers. Our research[16] reports that interviewees raised serious concerns raised during interviews that the DSO's proposed role of neutral market maker for network services will leave the actors in that market (potentially aggregators, community energy projects, suppliers, and other third parties) largely unregulated and free to charge what they can get away with, rather than what the future network charging methodology has carefully worked out is fair.

The need for debate on the future of the Fuel Poverty Network Extension Scheme

23. Our research reports that SGN gets widespread plaudits for its work on the Fuel Poverty Network Extension scheme, particularly in terms of how it leverages funding for heating systems and insulation available from different Scottish

[15] Soon to be published research by CFU – Energy Networks in Scotland and consumers- undertaken by the Centre for Sustainable Energy.
[16] Soon to be published research by CFU – Energy Networks in Scotland and consumers- undertaken by the Centre for Sustainable Energy.

Government-funded programmes (not available in England). While gas central heating remains the most affordable whole home heating option, it is fast becoming higher carbon relative to lower-carbon electric alternatives. Moreover, depending on the future of the gas network, the affordability of gas may become an issue within the lifetime of current heating systems. This creates questions for the future of the scheme.

24. While these questions do not need to be resolved immediately, they do need to start being explored and how network extension is incentivised under the RIIO 2 framework should be considered. Such exploration should take a whole system approach and look at how different sector plans for both electricity and gas may interact; with the overall aim of providing the lowest cost and lowest carbon heating solution for consumers – particularly for those who are currently off the gas grid and rely on expensive heating sources.

The need for whole system planning with integration of local heat and energy efficiency strategies

25. The Scottish Government is requiring (and funding) every local authority to develop a local heat and energy efficiency strategy, with a view to shaping future heat demand reduction and heat decarbonisation programmes. While the strategies are required to consider electric heating, the status of the local electricity network is explicitly excluded from consideration.

26. Our research reports that the DNOs think that it is important that they are involved in this strategy development to avoid decisions being made without considering network impacts (or network opportunities – such as using new smart storage heating as a system balancing facility). While the ultimate responsibility for local planning does not lie with Ofgem, or with the network companies themselves, it is important that the RIIO2 framework incentivises companies to undertake a *whole system approach* to business planning.

Ensuring confidence remains in the RIIO –ED1 SECV Incentive scheme

27. The research reported that confidence is dropping in the RIIO ED1 SECV incentive scheme, with suppliers losing confidence in the scheme due to:

    - What they feel is an inconsistent approach to the assessment process
    - The inability of assessors to provide clear articulation of the reasons why the scoring of different companies is as it is.

28. While the research reports that the SECV incentive has driven significant improvements in DNO activities in relation to vulnerable customers, at a low cost to consumers, it must be administered consistently and well to remain successful. Ofgem will need to re-establish confidence in the assessment process by establishing more continuity in staff/panel involvement and greater consistency in its approach if DNOs are to continue to be incentivised to improve by the SECV scheme as per it's intention.

29. Our soon to be published research[17] also highlights that Scottish DNOs are again at the bottom of table in 2016-17 for the SECV incentive. We encourage Ofgem to explore how other models, beyond rewarding poorer performing companies less than others, can truly incentivise companies to improve their performance. Without this, vulnerable consumers in Scotland will continue to be under supported by their DNO.

Dr Jamie Stewart
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[17] Soon to be published research by CFU – Energy Networks in Scotland and consumers- undertaken by the Centre for Sustainable Energy.