

To: network companies and other interested parties



Making a positive difference
for energy consumers

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To whom it may concern,

Follow-up: RIIO-2 Business plan submission and Ofgem's ongoing engagement with your company (you)

On 24 June 2019 I wrote to you confirming the process for submission of business plans to the RIIO-2 Challenge Group for 1 July and 1 October 2019, ahead of the submission of the final business plan to Ofgem by 9 December 2019.

We have subsequently received questions from network companies about a number of areas; to allow companies to progress their business plan development at pace we have decided to respond to these through this open letter as we believe they are of value to all stakeholders.

The queries have been grouped thematically and answers are provided to these below.

Business Plan Data Template (BPDT) / Licence Model (LiMo)

We have been asked about the timeline for finalising the BPDTs and LiMos and making these available to companies to form the basis for the final Business Plans to be submitted in December.

We plan to consult on the BPDTs (and related documentation as necessary) in early August, with a view to issuing a final version in week commencing 16 September 2019.

The planned timeline for the LiMo was agreed at the ENA RIIO-2 Financeability Modelling Technical Working Group on 4 July 2019. We aim to finalise the version to be audited by an independent party by 30 September 2019 and to release the final LiMo incorporating the outcome of the audit by 31 October 2019. For clarity, the scope of the external audit of LiMo will include the links to the Finance Business Plan Data Templates (FBPDTs). There are currently no plans to audit the FBPDTs themselves.

We further seek to clarify that we will be using the draft July BPDT submission to inform the direction of our analysis and ensure we have the necessary details and data to come to a timely view for our draft determinations, following receipt of the December 2019 final submission. Our cost modelling will be based on the final submissions and there is no carry-over of residual errors from the earlier submissions.

Process for determining RIIO-2 Output Delivery Incentives (ODIs)

We have been asked to clarify how we will consider all evidence provided to us related to ODIs in developing our determination and relevant timeline.

In our Sector Specific Methodology Document (SSMD) published in May 2019, we set out the principles we will apply when setting financial and reputational ODIs. We have provided companies with the opportunity to propose bespoke outputs in collaboration with their stakeholders and Enhanced Engagement Groups where they feel these are appropriately justified. Our Business Plan Guidance sets out the circumstances in which we consider a bespoke output may be appropriate and the minimum level of justification required.

In terms of prospective timings, the sector specific documents published in May 2019 set out the further decisions we expect to take with respect to the package of ODIs. This included our timeframe and high-level process for reaching decisions on the detailed parameters of ODIs (e.g. incentive strength, rates, target baselines). Consistent with these publications, we expect to set out our thinking on the value of the overall incentives package in the Draft Determinations published in Q2 2020.

For all decisions we make, including those in relation to outputs and incentives, we will take account of all relevant evidence provided to us. We are also clear we welcome ongoing engagement with our teams as we continue to refine our incentive proposals. In developing our RIIO-2 determinations, we will also hold open hearings in Spring 2020 to focus on specific areas raised by the Enhanced Engagement groups – these provide additional an opportunity for engagement along with the other channels which we adopt as part of the policy development process at Ofgem.

Early competition models

We have been asked to detail a set of objectives for early competition. As stated in our December 2018 consultation document, we consider that early competition could produce benefits for consumers by revealing new or innovative ways of solving network problems (such as grid constraints) and avoiding expensive reinforcement costs (for instance, by using flexibility providers). Our objective for RIIO-2 is to utilise early competition for projects where doing so produces net benefits for consumers.

Furthermore, we have been asked to specify features which we consider to be an integral part of early competition solutions for RIIO-2. We understand this request to relate to the flagging of projects or system needs in the Business Plan. In the May 2019 decision document we stated that “[i]n RIIO-2, certain projects may be subject to early competition” and that:

“[i]n order to help identify system needs which could be beneficially met through potential early competition models, network companies are required at this stage to ‘flag’ certain system needs in their Business Plans ... Flagged projects will not necessarily be subject to early competition. Equally, early competition may ultimately be applied to projects which are not flagged by the network companies in their Business Plans.”

For Business Plan submission, you are required to flag projects or system needs which exceed (or are likely to exceed) the threshold value of £50 million.

You are invited to ‘un-flag’, from among the projects or system needs that you have flagged as meeting the threshold value, any which you consider would have no reasonable probability of being addressed by an alternative solution (henceforth described as ‘**non-contestable**’). You would need to explain your decision to un-flag

any such projects or system needs. This will help us to focus on projects or system needs which are more suitable for early competition.

It is our intention to give network companies the flexibility to 'un-flag' those projects or system needs, if any, which they consider are non-contestable, and to explain their decisions.

Stakeholder engagement

We have been asked to clarify our expectation for enduring stakeholder engagement arrangements, the role of the Customer Engagement Groups (CEGs) and User Groups (UGs) relating to challenging or inputting into companies' Business Plans, and wider public consultations that the companies may conduct.

In responding to these questions we refer extensively to material we have previously provided either in our May Sector Specific Methodology Decision, the RIIO-2 Business Plan Guidance or the Enhanced Engagement Guidance.

Our assessment of business plans will take account of how you have designed your engagement using the enhanced engagement process. We expect your plans to provide evidence of the following:

- the appointment of company specific groups
- effective engagement with CEGs, UGs and the RIIO-2 Challenge Group
- robust and high quality engagement with stakeholders by the company in designing the plan

We will also take into account the process of engagement the plans have been subject to in their development, as well as the quality and ambition of the ongoing strategy for engagement to which the company is committing.

In our guidance on enhanced engagement, we have described the focus of these groups. For example, for transmission companies, we expect the groups to consider (but not be limited to) the following:

- the company's overall priorities and approach
- direct input to identifying investment requirements and outputs representing desired performance levels and service quality improvements
- associated totex budgets
- the stakeholder engagement the company has undertaken to inform their proposals
- the company's approach to innovation
- the range of scenarios the company has considered to anticipate future network requirements and the company's approach to managing uncertainty and associated risks
- alternatives to the investment proposals described by the company
- any issues of particular relevance to a local region

In developing your plans, it is essential that you carry out robust and high quality engagement with their stakeholders. In the guidance we also clarified that engaging with the CEGs and UGs is not a substitute for engagement with your end users or other stakeholders. The decision whether to undertake a general, public consultation on their business plans as part of your stakeholder engagement process is a decision for you to take. We will consider your approach in our assessment of the plan, along with the views of your CEGs or UGs and the RIIO-2 Challenge Group on your approach to engagement.

We also expect the plans to set out your approach to ongoing engagement in RIIO-2, including a strategy for engagement as well as a set of commitments to deliver the strategy. This strategy should:

- be strategic and proportionate, including how the company's approach reflects the particular circumstances of the company's geographic regions and its various network users, both domestic and industrial
- be inclusive of all stakeholders, including consideration of hard-to-reach groups as well as the needs of both existing and future consumers
- be responsive to stakeholder needs, including how the company will maintain an up-to-date understanding of stakeholders' needs as well as how it will ensure views are captured and incorporated into the day-to-day operation of the business
- be ambitious, including how the company has established performance commitments which are appropriate, well-evidenced and stretching
- be transparent, including how the company will measure progress against its commitments as well as any consequences for non-delivery of commitments
- deliver outcomes that network users and society value at a price they are willing to pay. The plan should provide evidence that costs associated with the delivery of commitments are efficient and provide value for money. This should include consideration of resource commitments to support engagement
- demonstrate senior-level buy-in and that engagement runs through all levels of the organisation
- incorporate and builds on the best practice methods learned in RIIO-1 and considers best practice methods employed in other industries

We consider that the CEGs and UGs could play a key role in monitoring the delivery of company Business Plans during RIIO-2, and you may equally give consideration to the future role of these groups. We will consider updating our Enhanced Stakeholder Engagement guidance in the future to provide guidance on the role of these groups beyond price control settlement process.

Yours Faithfully,



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