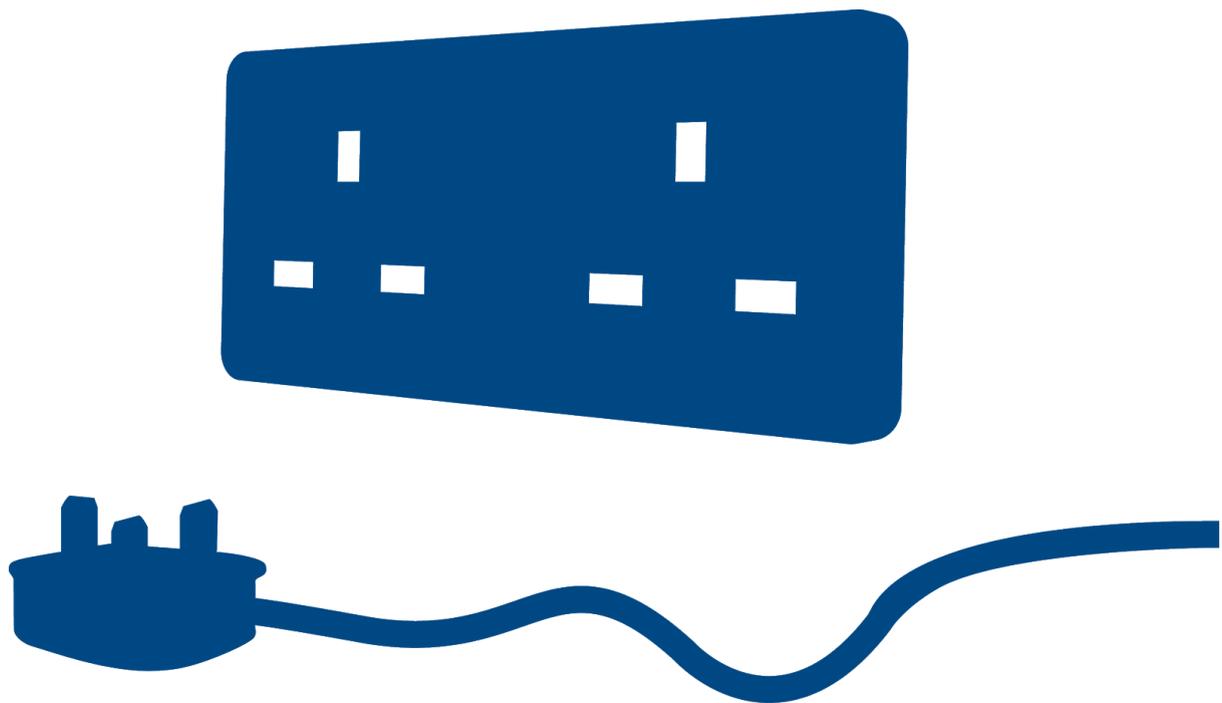


Ofgem Open Letter Consultation on approach to setting the next electricity price control (RIIO-ED2)

Citizens Advice submission
October 2019



Introduction

Citizens Advice welcomes the opportunity to respond to this consultation as part of its statutory role to represent domestic and small business energy consumers in Great Britain.

The RIIO-ED2 (ED2) price control process offers the opportunity to ensure that Great Britain's electricity Distribution Network Operators (DNOs) act in the best interests of consumers in an increasingly changing energy environment. As well as operating an effective and reliable electricity distribution service, DNOs will also need to play an integral part in enabling the transition to a net zero carbon emission world.

Ensuring a reliable and safe network will be a priority, however, it is essential that consumers are paying fairly for the costs of the distribution network, including being protected from the higher risks from the continuing development in the energy system. These changes, such as the development of Distribution System Operation (DSO) functions, the growth in flexibility providers and other distributed energy resources, and the technological changes in actively managing the networks, while less certain than previous practices, offer opportunities to provide a cheaper and more environmentally favourable electricity distribution system.

We remain supportive of Ofgem's intentions to enable investors in DNOs to receive a fair return on their investment whilst delivering an excellent quality service to consumers. One of the biggest challenges for Ofgem is to achieve this whilst ensuring DNO companies are working to a clear and realistic net zero roadmap (both internally, and in a wider sectoral facilitation role). As we mentioned within our response to the RIIO-2 Sector Specific Methodology consultation¹, we welcome Ofgem's focus on reducing the cost of capital for RIIO-2 and ED2. Some network companies have made voluntary returns back to consumers when there has been overcharging during RIIO-1. Western Power Distribution is an example of one of the electricity distribution companies undertaking a voluntary return. Although these companies have not returned all of the money identified through our analysis, the returns made so far are the

¹ Citizens Advice response to the RIIO-2 Sector Specific Methodology consultation: <https://www.citizensadvice.org.uk/Global/CitizensAdvice/Energy/Energy%20Consultation%20responses/2Citizens%20Advice%20-%20RIIO2%20sector%20specific%20response%20-%20March%202019.pdf>

right thing to do. There are still a number of companies who have taken no action. We think that Ofgem's proposals should include a consideration of a company's approach to voluntary returns, and specifically any voluntary returns made in the RIIO-1 period, when determining the settlement that the DNOs are given. Ofgem should be able to have more confidence in those companies that have taken action and returned money to consumers. Ofwat is taking this approach in PR19 in assessing water companies who have made voluntary returns.²

The current development of DSO functions by DNOs, including the overarching framework through the Energy Networks Association (ENA) Open Networks project, should lead to the establishment of a lower cost, and more responsive network while also facilitating the move to a low carbon emission environment. At present, the DNOs are in a primary position to start to develop these DSO functions. However, we recognise that the need for market neutrality, transparency, and the opportunity for other parties to be able to compete to drive down costs. As such, there may be a different final outcome for the DSO functions which may be spread across a range of parties, including non-DNO entities. As such, the ED2 price control will need to be flexible and designed to enable future delivery changes for DSO functions while enabling continued and speedy development.

The transition to a low carbon future with a more locally distributed and responsive electricity network should lead to lower bills for all consumers, however, there is a risk that some consumers, that may be less affluent or have other vulnerabilities, may not benefit as much as other consumers. The development of DSO functions will need a continuing focus on ensuring that the network changes are inclusive for all consumers. The DNOs are considering this issue via the ENA Open Networks project, and will need to ensure that the changes to the electricity distribution network are designed in an inclusive and low cost manner.

Our specific asks for Ofgem for ED2, described further below, are that:

- The issue of whether DNOs have undertaken voluntary returns when there has been overcharging of consumers during RIIO-1 is taken into account when assessing DNOs' business plans for ED2.

²Pages 9 and 10:

www.ofwat.gov.uk/wp-content/uploads/2019/01/PR19-initial-assessment-of-plans-Summary-of-t est-area-assessment.pdf

- The DNOs are assessed and incentivised for their plans to address decarbonisation goals, including the DNOs' own environmental impacts.
- There is consideration of costs, incentives, and outputs relating to DSO functions to be separated from the Business as Usual DNO activities.
- Reopener mechanisms are given high consideration as the primary means to address uncertainties within the ED2 price control period, e.g. for strategic investment or highly anticipatory investment.
- Consideration is given to how energy efficiency measures can be incorporated within the investment decision process when considering alternatives to reinforcement.
- Whole system solutions are designed to ensure that the widest collaboration of parties can be encouraged and suitably incentivised.
- Competition, including by non-network companies, is incorporated as widely as possible in ED2, to drive down consumer costs and foster innovative solutions.
- Consideration is given to assessing whether major strategic investments should be removed from the price control to foster competition and support innovation.
- Provision of data by DNOs to the market will need to be one of the priorities for ED2 and will require appropriate incentivisation and/or mandating to achieve the collaboration, openness, standardisation and interoperability required.
- Inclusivity for all consumers is a priority when developing the transition changes to the electricity distribution network.
- A review is conducted by Ofgem of the best practices and shortcomings from the enhanced engagement process undertaken for RIIO-2 for the transmission and gas distribution companies so that any improvements can be incorporated into the ED2 business planning process.
- Consideration be given to reforming the current Worst Served Customer and Guaranteed Standards of Performance mechanisms for consumer benefit.
- Reliability and security of supply issues may need reconsidering for ED2 to lock in past improvements and assess the merits of improved reliability standards.
- The DNOs' Distribution Future Energy Scenarios and other similar tools underpinning infrastructure planning is independently verified by Ofgem.
- The cost of debt index for ED companies, which is in a multi-period process of adjustment (i.e. the trombone), should be allowed to run its course and the processes undertaken in ED1 continued.
- The shift to CPI(H) should be conducted completely and at one point in time at the start of the ED2 price control. We support Ofgem's overall approach to setting the cost of equity.

- On the issue of the sculpted sharing factor in instances of high under- or over-performance, we are not opposed to introducing a sculpted sharing factor but we would welcome further discussion on how best this mechanism could be designed.

Consultation questions

Proposed objectives for RIIO-ED2

1. Do you have any views on the proposed objective for RIIO-ED2?

We support the proposed objectives for RIIO-ED2 (ED2). In particular, we believe that an effective, tough but fair settlement should act to protect consumers from paying too much for the electricity distribution network while also delivering the service that is needed in a world ever more reliant on a secure electricity supply.

We have noted the 3 output categories that are listed as the drivers for ED2, namely:

- Meet the needs of consumers and network users
- Maintain a safe and reliable network
- Deliver an environmentally sustainable network

We support the 3 output categories but also feel that there may be a need for further specific output categories to address the new requirements on Distribution Network Operators (DNOs) to deliver Distribution System Operation (DSO) functions. We have addressed this point at question 21.

Strategic approach to RIIO-ED2

We support the RIIO price control process as it offers the opportunity to incentivise companies to meet certain outputs of value to consumers as well as aiming to ensure a settlement that was value for money. The challenges facing the electricity distribution network in the forthcoming years, including the development of Distribution System Operation (DSO) functions and the drive to a net zero carbon target for Great Britain, will necessitate a revised price control framework for ED2. In particular, the outputs and funding for DSO functions may need to be designed separately from a Distribution Network Operator's (DNO) Business as Usual (BAU) activities. While the DSO functions are currently not firmly allocated to any particular institution, and many remain within the DNO's domain, there will be value in the future to consider the wider governance and

institutional arrangements surrounding the DSO activities, similar to the considerations that are being made for the Electricity System Operator (ESO). The requirement of a system operator to be a neutral market facilitator is an example, among other functions, where the BAU of a DNO could have a potentially conflicted position, or the appearance of a conflict, that may require a different governance solution. A single price control process that incorporates the DNO BAU activities alongside the DSO functions, however, well designed, may not resolve these issues. We have further described below our views on how to use the forthcoming ED2 price control to accommodate concerns regarding the DSO functions given that the DNO BAU and DSO activities currently remain combined in single corporate entities.

How to set price controls that support decarbonisation goals

The recent National Infrastructure Commission (NIC) report ‘Strategic investment and public confidence’³ addressed some of the changes needed to transition to a net zero goal by 2050. The report notes the need for the regulatory environment to facilitate the low carbon revolution and highlights the need to open up the energy markets to new players and ideas. The NIC also suggests “that most major strategic investments should be removed from the price control processes, where appropriate, and opened up to competition to support innovation” (page 9). We would ask Ofgem to consider NIC’s suggestion and open consultation on whether there are major strategic investments that would be appropriate to be beyond the price control process and be put to further competition beyond the network companies. Mechanisms and assessments for such investment will need to be robust to ensure that consumers and citizens are not overcharged and that assets are not stranded. We have also addressed this point at question 12. In the following questions, we have discussed the application of the ED2 price control in supporting decarbonisation goals.

2. To what extent should we take into account outcomes linked to decarbonisation targets, and what outcomes might this involve?

The setting of deliverables, outputs or incentives related to decarbonisation goals would be valuable in focusing attention of DNOs upon this extremely important area of government policy.

³ National Infrastructure Commission report, ‘Strategic investment and public confidence’, October 2019:
<https://www.nic.org.uk/wp-content/uploads/NIC-Strategic-Investment-Public-Confidence-October-2019.pdf>

Achieving net zero by 2050 will require the DNOs to amend their internal practices, develop new ways of working and facilitate a market for alternative services to meet demand cost-effectively. However, in practice, many decarbonisation activities are beyond the control of DNOs. For instance, the uptake of EVs, wider energy efficiency measures, and the decarbonisation of heat via heat pumps or alternative heating technologies will require continued government policy initiatives, the cooperation of the public, and the development of products and services via the market beyond the electricity industry. DNOs, however, can play an important part in facilitating and enabling these changes, and preparing their own networks to respond to the development of new technologies, products, services, and to understand demand changes. It should also be noted that each DNO licence area is likely to have differing requirements to achieve net zero dependent upon the specific factors within their region. These different factors could include the capacity and likely future extent of low carbon generation, the density of population and likely demand requirements, the nature of existing constraints on the system, and the local government goals which may be more ambitious than central government timelines.

While it will not be straightforward to establish appropriate measures to reward DNO behaviour in playing their part in facilitating net zero, the DNOs have a critical role in enabling the electricity system to adopt lower carbon generation, use new technologies to reduce overall and peak demand, and distribute data to encourage novel solutions.

DNOs' Business Plans for ED2 could be rewarded as part of any Business Plan Incentive to reward a DNO's clear understanding of net zero goals and the implications for their licence areas. Business Plans would need to incorporate the Energy Networks Association (ENA) Common Scenario and reflect local needs within Distribution Future Energy Scenarios (DFESs) for their licence areas and demonstrate how their plans will work towards a net zero outcome. DNOs will need to show how their specific tasks will respond to these scenarios to ensure facilitation of net zero in their licence areas.

While the focus of this question is upon decarbonisation goals, we would also expect that the ED2 price control addresses the DNOs' other environmental impacts, such as biodiversity, Sulphur Hexafluoride (SF6) gas emissions, noise pollution, and waste production. We have noted these aspects at question 3.

We have outlined further output and incentive suggestions regarding setting a price control to support decarbonisation goals below.

3. Are there activities that DNOs are best placed to carry out in order to achieve these outcomes? What are the alternatives? Why would it be appropriate for energy consumers to fund these activities?

DNOs' own greenhouse gas footprint

An output which is directly within a company's control would be addressing their own greenhouse gas footprint (including carbon output and greenhouse gases such as SF6). Companies could be incentivised to reduce their total greenhouse gas output against measurable and declining targets.

Whilst we support the inclusion of leakage targets for SF6, this in itself does not represent true improvement. The level of action that is required of DNOs in ED2 for their reliance on SF6 to be in line with net zero targets must go beyond leakage reporting. Our view is that the gradual but meaningful replacement of SF6, with significantly more sustainable alternatives, should form part of the incentive regime for DNOs. We have also covered this point at question 29.

Energy efficiency

Energy efficiency will be an important element in the decarbonisation agenda leading to reductions in overall and peak demand. Trials, such as Scottish and Southern Electricity Network's (SSEN) SAVE project⁴, have demonstrated the value in energy efficiency measures including significant reductions in peak demand from simple solutions such as use of LED lighting. Energy efficiency will need to have a higher focus for ED2 and beyond, although the exact mechanisms to include energy efficiency measures as options within DNO/DSO activities are not clear. For instance, network asset decisions are currently looking at reinforcement versus flexibility solutions, however, energy efficiency, with its longer term (or effectively permanent) reduction in demand may be an even better cost efficient and low carbon option. At present, energy efficiency options are not factored into the Cost/Benefit Analysis for network decisions.

In a similar vein, DNOs may be in a good position from their knowledge of electricity networks, and products and services, to be suitable advisers to businesses and consumers to reduce their energy usage and/or peak demand profiles. It may be possible to encourage DNOs to undertake a role within their

⁴ SSEN Save Project: <https://save-project.co.uk/>

communities to directly drive energy efficiency or on-refer to specialist agencies that may be able to assist consumers, including those with vulnerabilities. As we have seen with the Gas Distribution Networks (GDNs), companies can play a part in assisting consumers to access grants or other energy efficiency solutions via referral partners including water companies, GDNs, and charities. DNOs could help ensure consumers receive energy saving and tariff advice, and understand efficiency options, including solar or storage products and services.

We are of course mindful of the overlaps with the Energy Company Obligation (ECO) scheme run by suppliers. However, Citizens Advice has long argued that ECO isn't working and projections show it will not reach its targets.⁵ The incentives the scheme puts on suppliers are not encouraging the right behaviours. In its stead, we would like to see an area-based approach to delivering energy efficiency, which engages local authorities, DNOs, GDNs, and landlords.

We would recommend consultation with DNOs and other stakeholders to determine how energy efficiency should be factored into their activities of DNOs, including how energy efficiency could be included within Cost/Benefit Analyses. It will be suitable to consider third parties' roles in delivering wider energy efficiency measures as an alternative to DNOs which may be more cost effective or efficient but could potentially involve a DNO coordination or referral role. See also our response to question 28.

Whole system solutions

Decarbonisation will require a wide range of solutions that cross sectors such as heat and transport as well as the electricity industry. The DNOs will increasingly need to work closely with others in the gas transmission and distribution networks, the electricity transmission companies, and with the ESO. Local drivers of decarbonisation will also be important to achieve the net zero goal such as devolved governments, local councils, third party flexibility and aggregator companies, and sustainability and community groups. The ED2 price control will need to ensure that DNOs are suitably encouraged to work holistically across these sectors and agencies. Mechanisms to incentivise whole system solutions could include:

⁵ Citizens Advice, Beyond ECO: the future of fuel poverty support (2018) <https://www.citizensadvice.org.uk/about-us/policy/policy-research-topics/energy-policy-research-and-consultation-responses/energy-policy-research/beyond-eco-the-future-of-fuel-poverty-support/>

- Recognition within a Business Plan Incentive that the DNO has fully considered and incorporated whole systems thinking.
- Amendments to Cost/Benefit Analyses to include partial or wholly non-DNO solutions.
- Sharing of incentives or innovation funds to non-DNO participants including opening of funds to competitive third party solutions.
- Measures of reinforcement or replacement avoided.
- Extent of use of flexibility and other alternatives.
- Extent of energy efficiency measures delivered and their impact.
- Extent of green energy accommodated at distribution level.

We note that the move to whole system solutions may involve changes to licence conditions as these solutions may require cooperation beyond traditional DNO licence areas and in coordination with other DNOs, transmission companies, and the ESO, among others.

Publication of network data

Dissemination of data about a DNO's network will facilitate opportunities for third parties to offer flexibility solutions, embedded generation, aggregated services, and to develop innovative products and services. As a result, there should be reductions in overall and peak demand and a more cost efficient network which should aid the decarbonisation agenda. We therefore recommend that incentives are designed to encourage companies to rapidly develop data dissemination mechanisms which are interoperable, publicly accessible, comprehensive and up to date.

Stakeholder and consumer support

Stakeholder and consumer engagement should be at the core of DNO activities, and their views on the high level decarbonisation journey, as well as the specific impacts on them, should be sought. In this area there is a lot of scope for co-creation of service processes, and deliberative research to understand how the decarbonisation journey will benefit all consumers.

4. How should we assess DNO funding requirements and measure DNO performance in these areas?

See also responses to questions 2 to 3. Funding requirements to meet the decarbonisation agenda, as previously stated above, will necessarily be different within each DNO licence area due to:

- Varying support by consumers and stakeholders for the DNOs' Business Plan elements relating to decarbonisation
- Local factors that may determine:
 - Future demand
 - Pre-existing network capacity and current and future constraints
 - Availability of reinforcement and replacement alternatives
 - Local decarbonisation goals and timelines

Therefore we believe that DNOs should draw on these factors to justify their spending on decarbonisation and environmental impacts. For example, they should demonstrate how important decarbonisation is to their stakeholders, whether consumers are willing to pay for their proposals, and how local decarbonisation goals are driving the need for network investment.

It will be necessary for Ofgem to be flexible to respond to the regional differences that will drive funding requirements for a particular licence area with recognition that localised drivers may create different timelines for responding to the decarbonisation agenda.

5. How should we incentivise DNO performance when the achievement of outcomes could be dependent on the actions of others?

See response to questions 2 to 3.

How to set price controls that support strategic investment

6. How do we ensure that network companies are best placed to undertake strategic investment and manage the associated risk? How should the risks of these investments be managed?

Strategic investment occurs when a DNO expands its network in anticipation of increased demand. This investment traditionally involves network reinforcement, which feeds into the Regulatory Asset Base, although other non-reinforcement solutions are becoming available such as using flexibility providers. Building infrastructure or contracting flexibility in advance of demand is suitable when there is clear demonstrable need in the near future.

Undertaking strategic investment in unclear circumstances risks stranded assets, where the demand does not materialise and the assets are not required. Such an outcome is costly for consumers who would potentially be paying for this unused infrastructure for many decades to come.

The environment for DNOs is changing resulting in increasing uncertainties relating to:

- Future demand (e.g. extent of EV uptake, decarbonisation of heat and transport)
- Increased embedding of generation at the distribution level
- Technology changes that may drive different requirements for DNO infrastructure (e.g. active network management relating to Distribution System Operation) or different and potentially cheaper solutions compared to reinforcement or replacement
- Regional differences created by more ambitious decarbonisation goals
- Central government policy shifts and initiatives
- The need to design new systems and processes for Distribution System Operations

Protecting consumers from paying for an inefficient electricity distribution system should be a priority coupled with the need to ensure that networks provide the services that consumers need in a timely manner.

To meet these consumer priorities, the DNOs will need to have suitable planning processes in place to understand what is a certain requirement for imminent infrastructure solutions and where there are uncertainties and their extent. The price control, in turn, will need to be able to assess and fund those more imminent infrastructure solutions while responding flexibly and rapidly when uncertain needs become certain.

As such, we believe that DNOs will need to have:

- Comprehensive, up to date and accurate local Distribution Future Energy Scenarios (DFESs) which incorporate certain and less certain elements relating to infrastructure solution requirements.
- Clear explanation as to why their DFESs would differ from the ENA Common Scenario.
- A mechanism to rapidly update the DFES to ensure that they incorporate the latest changes in technology, demographic changes, technology improvements, National Grid Future Energy Scenarios, and local and national government amendments.
- Responsive asset management and flexibility solution departments to identify the most efficient and cost-effective solution that ensures incorporation of any new developments that may offer cheaper alternatives to network reinforcement or network replacement.

- Up to date and justified costs for Distribution System Operation functions.
- A clear policy to take a no or least regrets pathway to ensure that future changes are facilitated at least cost.
- Stakeholder and consumer support for their intended investment planning processes within their Business Plan, including consideration of current and future consumer balance.

Similarly, the ED2 price control will need to be able to:

- Verify the validity of the underpinnings and outputs of the DFESs and the resultant no or least regrets investment pathways.
- Ensure that DNOs update these documents regularly and appropriately.
- Respond agilely to requests from DNOs for additional funding to accommodate changes to anticipated certain need and Distribution System Operation costs.
- Keep up to date with availability and cost profiles of non-network reinforcement solutions to ensure that the cheapest and most efficient solutions are part of DNOs' decision-making.
- Use indexation on costs, where feasible, to ensure accurate and up to date cost estimates.
- Ensure that DNO Business Plan strategic investments show appropriate support from stakeholders and consumers.

7. What, if any, changes to the framework are required to support strategic investment?

At present, the ED1 framework funds more certain investments within the Business Plans and requires the DNOs to use either volume drivers or reopener mechanisms to request new funding for less certain investments or costs. Other regular but uncertain costs (such as Ofgem licence fees or business rates) are permitted to be passed through to consumers.

Given the level of uncertainties likely to be forthcoming within the ED2 period, it has been suggested by some DNOs that the DNOs should receive funding in advance of anticipated need that they could draw down upon as and when the need becomes more imminent. Unused funding could then be returned to the consumer as it becomes clearer that it is not needed. We believe that there are significant risks to this proposal, as DNOs may argue that the need is almost imminent and retain funding for a considerable period of time while the need never materialises. Costs for current consumers could therefore be unnecessarily raised.

The option of volume drivers, at first glance, appears to offer a better solution in that DNOs would have more certainty of funding in the event of imminent or actual demand increase (e.g. in the event of a set increase in EV uptake, then a DNO would receive £x additional investment funding to increase capacity). However, this system may be too simplistic to manage the complexity within the different DNO areas. For instance, for the same level of EV uptake one DNO licence area may have significant capacity constraint issues and need infrastructure solutions whereas another DNO licence area could have capacity to accommodate increased need without any further investment. As such, we do not believe that volume drivers offer a suitable mechanism to be able to respond to such regional DNO differences. We are, however, open to considering such drivers if DNOs can identify a straight-line relationship between the activity and the cost (as with the current volume driver for smart meter roll-out).

A shorter price control period (say 2 or 3 years rather than 5) offers some benefits in allowing for adjustment to funding for DNOs to respond to changes in investment need. However, a shorter price control process may result in an almost permanent state of Business Planning preparation that may be counterproductive to the smooth operation of the business and may impact on a company's focus to help deliver decarbonisation by 2050 and to undertake necessary development of DSO functions. There is a risk that constant business planning may increase costs to consumers.

As such, the most suitable mechanism to accommodate uncertainty and regional differences appears to be the reopener mechanism. However, to ensure that consumers are able to have the services that they want and when they need them, the price control reopener mechanisms will need to be highly responsive and rapidly deployed to ensure that DNOs can call on funding in the appropriate time-frame. A consistent and clear set of reopener mechanisms will need to be devised.

Further, we encourage Ofgem to think carefully about how the reopener framework could be improved from ED1. During the years 2023-2028 we anticipate various potentially large spend items that may manifest as a direct result of the UK's energy transition towards our net zero climate target. Similarly, a proportion of the bids for the May 2019 ED1 reopener related to anticipatory investment associated with the low carbon economy. However many of the bids for that reopener round fell short of what was required in order to properly

assess the needs case, merits and value for money. Ofgem's current minded-to position is to disallow many of these costs.

Given that some key activities needed in ED2 will not be visible until after the final Business Plans have been submitted, Ofgem must ensure that reopener rounds during ED2 accommodate the likelihood of high volumes of bids, of high value, and of an anticipatory nature. This will require Ofgem to provide the correct level and mixture of staff resources in these teams, as well as significantly more clarity on the level of detail required in the published bids. This latter point should avoid unnecessary and widespread redactions of information as witnessed in the recent reopener round.

A further element to reduce the risk relating to investment decisions could be the use of a review body to assess higher value strategic investments, and the justifications for needs and costs. This body could be an independent organisation, such as ESO using a model similar to the Network Options Assessment tool, or be drawn from experts with knowledge of the DNO industry. However, the body would need to be suitably independent to provide assurance on decisions, and responsive to rapid changes, and effectively handle potentially many lower value decisions.

8. How should we hold the companies to account for the delivery of strategic investment, and the outcomes that they are expected to deliver?

As outlined within the responses to questions 6 and 7, there are significant risk reductions in holding the companies to account if funding is only released as strategic investment is justified. However, holding the DNOs to account for the outcomes that they are expected to deliver can be incorporated within a range of licence condition outputs, price control deliverables, and incentive mechanisms. Expected outcomes could be measured via links to, for example, the rapidity of connections and associated customer satisfaction for:

- Embedded generation
- Aggregators that may reduce demand and/or carbon emissions
- Households and businesses to connect EVs.

How to set price controls for DSO functions

9. Is there a need to separate out the revenues and outputs for 'traditional' DNO functions from DSO functions? How could this be achieved?

DSO functions will be vital elements in the drive to establish a cost-effective transition to a low carbon future. At present, some DSO functions are better understood than others in terms of the likely best party that could deliver the function, the interactions with other DSO functional elements, and the costs associated with each element. As such, it is not clear which parties could deliver these functions most effectively now or in an evolving technological future. The work of the ENA Open Networks project⁶ has been instrumental in outlining 'Future Worlds' that could incorporate these functions and analysing the relative costs and benefits of selected options and delivery partners. Citizens Advice has contributed to this debate via our participation in the ENA Open Networks Advisory Group and via consultation responses⁷.

Given the uncertainties surrounding the DSO functions, we would recommend a least regrets pathway that would aim to ensure that the most currently cost effective and efficient mechanism for delivery is maintained. Optionality should remain, however, to ensure that development could take place to transfer functions to other existing parties. For example:

- DSO functions could be split away into a separate legal entity similar to the ESO
- Some DNOs could take on DSO functions for other DNOs
- The ESO could take DSO functions
- Other third parties could take functions such as market platform operation

While the uncertainty remains regarding the best allocation of DSO functions to parties, it would appear prudent to ring-fence the funding and outputs for DSO functions separately from the DNOs' business as usual (BAU) activities. This separation would then facilitate a transfer of DSO functions and associated funding and output measures to a different player, if needed.

For the effective separation of DSO functions and their funding and outputs, a detailed listing of such functions and associated costs will need to be compiled. We are aware that many DNOs are already calculating the costs for the DSO

⁶ ENA Open Networks Project:

<http://www.energynetworks.org/electricity/futures/open-networks-project>

⁷ Citizens Advice response to ENA Open Networks project consultation on Future Worlds Impact Assessment:

<https://www.citizensadvice.org.uk/Global/CitizensAdvice/Energy/Energy%20Consultation%20responses/ENA%20ONP%20-%20Future%20Worlds%20Impact%20Assessment%20-%20CA%20response.pdf>

functions and have, at least in part, separated DSO functions in-house for independence, transparency and efficiency purposes. It therefore appears feasible during the ED2 price control consultation process to request DNOs to determine their DSO functions and their associated costs. Collation of this information will assist in ring-fencing the various IT, personnel, and equipment costs that can be firmly attributed to DSO functions as per Ofgem's 'Open Letter consultation on approach to setting the next electricity distribution price control (RIIO-ED2)'⁸ at Figure 1 (page 8).

A new set of outputs and incentives will need to be determined for the DSO functions and could be linked to the functions as outlined within Ofgem's consultation at Figure 1, e.g. an output could be produced which is linked to timely and accurate forecasting of demand and generation. We would recommend using the ED2 consultation and workshop process to define these outputs and incentives, and any necessary separate licence conditions for DSO functions. We further recommend incorporating suitable mechanisms from the RIIO-2 ESO price control process to inform the output and incentive mechanisms, and licence conditions for the DSO functions.

10. In the event of the DSO function being delivered by a separate party, how might we determine the revenues for DSO activities? What type of funding model would be appropriate to set DSO revenues? In this event, would changes also be required to DNO revenues and outputs?

If DSO functions are delivered by a separate party (and even where they are continued within the DNO companies), we believe that there would be value in evaluating the institutional and governance framework that would be most suitable to deliver DSO functions. The framework should ensure that the DSO-delivery bodies are transparent, accountable, reduce conflict potential, and offer reduced risks for consumers in being overcharged. The most appropriate institutional and governance framework for DSO functions is not yet established, however, we believe that consideration should be given to a wide range of options such as the benefits of retaining the current DNO/DSO combined model, the introduction of legally-separate companies undertaking DSO-only functions, the value of not-for-profit institutions, or the use of governance arrangements involving wider community or stakeholder input. The funding model or models that may be ultimately designed to accommodate the DSO functions may

⁸ Ofgem Open Letter consultation on approach to setting the next electricity distribution price control (RIIO-ED2):
https://www.ofgem.gov.uk/system/files/docs/2019/08/open_letter_consultation_on_the_riio-ed2_price_control.pdf

therefore need to be different from the current price control process. Any future model will need to establish the funding requirements of each entity and suitable methods for setting measurable targets including value for money for consumers.

As the DSO functions are currently remaining within the DNO structures, and therefore within the ED2 price control process, it is recommended that the revenue allocation processes for the ESO be used as a basis for assisting in understanding the likely DSO function costs and how revenues could be determined. The functions (and their associated costs), however, may differ between the ESO and the DSO and these functions and costs should be collated during the ED2 consultation and workshop process (see also response to question 9) to facilitate determining the appropriate revenue allocation for DSO functions.

When determining costs for the DSO functions, it will be necessary to understand the shared overheads that may be allocated by the DNO to the DSO for cost-recovery purposes which may include, for instance, premises, shared management, and payroll services. These overhead costs may need to be appropriately accounted for should there be a separation of DSO functions from a DNO to a different party.

11. Where a DNO is undertaking a DSO function, what type of outputs or outcomes are necessary to measure how efficiently they are performing this function? Over what time period could these be measured?

As mentioned in the responses to questions 9 and 10, it will be necessary to compile a set of outputs and outcomes appropriate to the DSO functions. We would recommend incorporating those outputs and outcome mechanisms from the ESO price control that mirror those within DSO functions for consistency of approach. Potential outputs could include measures relating to market participant/customer satisfaction, decarbonisation progress, and reinforcement avoided, for example.

We also recommend using the functional breakdown within the Ofgem consultation document at Figure 1 as the basis for designing outputs tied to individual functions and deciding suitable timelines for measurement progress. The continuing ED2 consultation and workshop process offers an opportunity to develop such output and outcome mechanisms.

While we recognise that DNO licence areas may have differing factors that may lead to varying DSO function solutions, wherever possible, consistent output and outcome measures should be adopted. Consistency of output measures would offer the means to identify comparative DNO forward progress and highlight best practice.

How to set price controls that drive innovation and competition

12. In what ways could the existing arrangements drive more innovation and competition?

In a future energy world which is required to be more responsive, reduce peak and overall demand, and operate with new DSO functions, it is vital that innovation and competition is fostered to ensure a drive down of costs, development of new technologies and solutions, and to achieve a low carbon environment.

As described in our response to the Ofgem RII0-2 Sector Specific Methodology consultation,⁹ we welcome the potential to involve more third parties in enabling new business models and technological solutions and that they should be able to access direct funds from Ofgem for these purposes. The NIC report 'Strategic investment and public confidence'¹⁰ (page 9) also suggests that major strategic investments should be removed from the price control processes, where appropriate, to open up competition to support innovation. As such, we would recommend that consideration be given to which elements of electricity distribution spending could be outside the price control to facilitate competition and innovation. Mechanisms and assessments for such investment which are beyond the price control will need to be robust to ensure that consumers are not overcharged and that assets do not become stranded.

Those elements that remain within the price control, however, should be opened up to as many players as possible. We believe that there will be a need to ensure

⁹ Citizens Advice response to the RII0-2 Sector Specific Methodology consultation: <https://www.citizensadvice.org.uk/Global/CitizensAdvice/Energy/Energy%20Consultation%20responses/2Citizens%20Advice%20-%20RIIO2%20sector%20specific%20response%20-%20March%202019.pdf>

¹⁰ National Infrastructure Commission report, 'Strategic investment and public confidence', October 2019: <https://www.nic.org.uk/wp-content/uploads/NIC-Strategic-Investment-Public-Confidence-October-2019.pdf>

DNOs provide data access to third parties, where necessary, to enable innovation. There may also be the requirement for DNOs to permit third parties to connect to their infrastructure to test new products and services. The access to data and infrastructure connection may require firm Ofgem guidance or legislative underpinning.

We believe that innovation by DNOs should be seen as more BAU within their business planning although recognise that new partnerships may emerge that require access to specific innovation funding pots. Such partnerships may involve groupings such as multiple DNOs, DNOs and other transmission or gas distribution companies, DNOs and the ESO, or DNOs with other third parties. Innovation funding should also be accessible to third parties beyond the DNOs.

We also welcome the proposed increased focus within ED2 for furthering competition beyond current mechanisms. This may necessitate a separate independent body to help to decide the most suitable and effective solution. We have addressed the potential value of such a body at questions 35 and 36.

How to set price controls for a smart, flexible energy system

13. To what extent should we set (and incentivise performance against) baseline totex allowances for activities where flexible solutions could be provided?

Under ED1, DNOs and consumers could benefit from the Totex Incentive Mechanism where the savings from a company's more cost-efficient choice would be shared between consumers and the companies. The sharing rate for DNOs was set at the outset of the price control process and gave relatively high sharing factors to companies to encourage cost efficiencies. These outperformance sharing factors in ED1 are between 53% and 70% in favour of companies although most are in the 50s by percentage.

For ED2, the choices being made by DNOs in managing their networks will involve more complexity. The alternatives to reinforcement or replacement of infrastructure could increasingly involve new technologies or flexibility services provided by third parties, for instance. It is also likely that novel technologies may emerge during the ED2 price control period which will enable further cost savings to be made compared to traditional infrastructure. As such, setting a totex allowance for ED2 with firm knowledge of future costs may prove more

difficult than in the past. There is therefore a risk that a higher totex allowance may be set than is needed with the potential for higher levels of Totex Incentive Mechanism outperformance by companies and consequently unnecessary costs for consumers.

If the Totex Incentive Mechanism is retained for ED2, then it may be valuable to factor in an estimate of the likely drive-down in costs that may result from new technologies and alternative products using, in part, the levels of underspend seen by DNOs during ED1¹¹ with an additional reduction factor related to the developing market for third party products and services. There would also be value in reconsidering the relatively high sharing rates for DNOs (up to 70%) that were established under ED1 to reduce potential high outperformance that may result from using alternative products and services that are more likely to become established during ED2.

14. Should we instead set allowances based on the costs revealed through the flexibility tendering process? How might this work?

As the BAU for DNOs changes from simpler asset management decisions relating to replacement or reinforcement of network infrastructure, it may be useful to reconsider the methodology for setting allowances relating to the maintenance of the networks. As the costs for the new alternative products and services may potentially reduce rapidly due to the development of this currently nascent market, it may be valuable to have a responsive mechanism during ED2 to use costs revealed through the tendering process as suggested by the question.

It would be useful to address this question during the continued consultation and workshop processes for ED2. In particular, it would be useful to consider how to best ensure that allowances and incentives are appropriately set:

- For assessing options for network reinforcement and replacement decisions. Including how these decisions can be made transparently, and in a market neutral way.
- To ensure that the most up to date market costs for alternative products and services are included in decision-making.

¹¹ Ofgem ED1 Annual Report 2017-18:
https://www.ofgem.gov.uk/system/files/docs/2019/03/rriio-ed1_annual_report_2017-18.pdf

- So that the allowances can be reformulated to take account of any drive-down in costs relating to the development of the market for alternative products and services.
- To allow for third parties to offer solutions to ensure competition and more cost-efficient options to be selected.
- To ensure that holistic whole system solutions are considered and rewarded which may involve awarding revenues to non-DNO participants.

How to set price controls in a big data environment

15. To what degree should DNOs modernise their handling practices to adhere to data best practice, and therefore (among other things) provide available, transparent, and interoperable data about their networks? What measures will be needed to ensure data remains secure?

DNOs, as part of the necessary development of DSO functions, will need to collate and handle large amounts of data including relating to the capacity on their networks, constraint zones, connections of distributed energy resources, potentially low voltage household and business usage profiles, and active information on dispatch on contracted flexibility resources. We believe that the DNOs should be required to follow the recommendations of the Energy Data Taskforce¹² on the topics that the Taskforce believe to be critical to ensuring an effective future energy system:

- Digitalisation of the Energy System
- Maximising the Value of the Data
- Visibility of Data
- Coordination of Asset Registration
- Visibility of Infrastructure and Assets

Ofgem, as part of ED2, should require periodic updates from the network companies to ensure that they are progressing appropriately against the recommendations. Business Plans should clearly state how the company will meet the requirements of the Energy Data Taskforce recommendations.

16. How should we structure RIIO-ED2 to encourage metadata to be made available, and for data to be presumed open? How should we measure DNO performance in this area, and on what basis should funding be set to deliver relevant outcomes?

¹² Energy Data Taskforce recommendations June 2019:
<https://es.catapult.org.uk/news/energy-data-taskforce-report/>

We have noted within our response (to be published in October 2019) to the Ofgem 'Position Paper on Distribution System Operation: our approach and regulatory priorities' that we believe that data is a key enabler in the future energy system, and we support the Energy Data Taskforce¹³ staged approach to establish a 'Modern, Digitalised Energy System'. In the drive to achieve this new energy system, it will be necessary to ensure that data is as open as possible and readily transferable to market platforms, other DNOs, the ESO and other third parties. Interoperability and use of data standards should be priorities. We recommend that Ofgem continues to work with the industry, e.g. via the ENA Open Networks project among others, to establish measurable standards that will need to be put in place to develop an open and effective interoperable set of systems. We support the move to ensure data best practice standards and welcome a timeline for implementation. DNOs should report periodic progress to Ofgem showing how they are achieving these standards against the timeline and any set output targets or incentives.

Ensuring that DNOs meet the desired outcomes for data collation and sharing, including timely performance, could be met with a number of mechanisms, such as requirements under licence conditions, price control deliverables, or output incentives. While incentives may generate the desired behaviours, mandated behaviour via a price control deliverable or licence obligation with minimum service standards, if properly funded, may be sufficient. Incentives may prove more costly for consumers than a minimum standard mechanism. We would recommend that the options to generate the correct behaviours be explored within the further ED2 consultation and workshop process.

17. Do you agree with the themes we plan to include in our guidance on data best practice?

We agree with the proposed themes for data best practice to make data more visible, open, and interoperable, which will be essential for an efficient digitised energy system. See also our answer to question 16.

RIO-ED2 Framework Consultation

Length of the price control

¹³ Energy Data Taskforce report, June 2019:
<https://es.catapult.org.uk/news/energy-data-taskforce-report/>

18. We welcome views on our proposed position of a five-year price control for RIIO-ED2.

The proposed position of a 5 year price control for ED2 is supported by Citizens Advice. Given the uncertainties within the next decade surrounding the decarbonisation agenda, the move to DSO functions, and potential national and local government policy changes, we believe that a shorter price control is suitable. As discussed at question 7, we do not advocate for a much shorter price control e.g. 2 or 3 years. While a much shorter price control period appears to offer some benefits in allowing for more frequent adjustments to funding for DNOs, there are also potential drawbacks. DNOs may find themselves in a near constant state of business planning preparation that may be counterproductive to the smooth operation of the business and may impact on a company's focus to help deliver decarbonisation by 2050 and to undertake necessary development of DSO functions. Constant business planning may also unnecessarily increase costs to consumers. We prefer reopener mechanisms to manage the risks of uncertainty.

As detailed above (see question 7), we have some concerns related to the management of reopeners in ED2, which we predict may be more common (and potentially of high value) due to the need to be responsive to the means of achieving the net zero target. Whilst we support a 5 year price control, adequate resource - and clarity of process (particularly around the redaction of information) - needs to be in place to ensure that reopener bids are provided the same level of scrutiny as other items that will be known about (and detailed) in ED company Business Plans.

19. Are there any elements of RIIO-ED2 price control that we should consider setting over a longer or shorter period? Please give reasons.

As discussed above at questions 6, 7 and 8, there are many uncertainties within the next price control including the likely uptake of electricity-using technologies for transport and heat, amendments in national or regional governmental policies that may drive changes, and the full costs of delivering DSO functions. In effect, a reopener mechanism is a form of shorter price control for certain elements, and we support the reopener mechanism to respond to changes that may occur within the price control. The elements that would be suitable for inclusion within reopener mechanisms could be where there is:

- Investment needed due to unexpected increases in uptake of EVs or heat pumps, or following announcements of major national or local policy changes.

- Development in understanding of the costs and functions relating to DSO, and/or where the DSO functions are distributed to non-DNO parties.
- Substantial technological changes (e.g. in reducing demand) which could drive more cost-effective or efficient solutions.

Giving consumers a stronger voice

20. We welcome views on whether these enhanced engagement arrangements are appropriate for RIIO-ED2.

We support the extension of the enhanced engagement arrangements (i.e. Customer Engagement Groups (CEGs), the RIIO-2 Challenge Group, and public hearings) to ED2. Employees of Citizens Advice have been sitting on 3 GDN CEGs for the past year, and have joined 3 ED CEGs recently, and have contributed to Transmission and ESO User and Stakeholder groups. We believe that these enhanced engagement arrangements can result in more robust and consumer friendly company action and Business Plans.

Nevertheless, we would welcome Ofgem commissioning a review of the enhanced engagement process to understand its benefits and shortcomings. Ofwat's review¹⁴ of the PR14 challenge process could serve as a guide.

We suggest the following as improvements to the challenge process:

- Companies should more rigorously and consistently document the action they have taken as a result of CEG challenges. They should also publish the costs of their CEGs. Since CEGs are partially paid for by consumers' money, it is important to be able to demonstrate the value and impact of these groups, both qualitatively and quantitatively. From membership on these groups, we know how difficult this can be but an earnest attempt needs to be made.
- We did observe that initially the CEGs were given a broad remit of the Business Plan aspects they should review¹⁵. Over 2019, Ofgem became increasingly specific in the aspects they wanted the CEG to comment on. For ED2 it would be helpful if the scope and expectations were set and are not overly amended.

¹⁴

<https://www.ccwater.org.uk/wp-content/uploads/2014/07/Customer-Challenge-Group-process-Review-of-lessons-learned2.pdf>

¹⁵

https://www.ofgem.gov.uk/system/files/docs/2018/04/riio-2_enhanced_stakeholder_engagement_guidance_v13_final.pdf

- The guidance document may need to be updated to reflect the potentially new areas CEGs should scrutinise such as the DSO transition and whole system outcomes. It would be helpful for all if this was done in good time ahead of draft business plan submissions.
- Ofgem resourcing to support the work of the CEGs and the CEG Chairs will need to be maintained.
- We welcome the proposed move to have one draft Business Plan rather than the two drafts that were required for transmission and gas distribution companies. This didn't leave much time to make amendments between drafts and have in depth discussions.
- As set out in May 2018:¹⁶
 - We would find it helpful if Ofgem provided the CEGs with an indication of what "quality engagement" means, and an indicative list of challenge questions to help new CEG members get up to speed with their role. The current Business Plan guidance only gives very high level points on what "quality" means.
 - Companies should publish the report that Ofgem is requiring from them about the arrangements put in place to ensure the CEG's independence. This way third parties including consumer bodies will be able to assess and compare across companies.
 - The RIIO-2 Challenge Group has been a valuable mechanism within the transmission and gas distribution price control process, especially where it has looked at strategic sectoral issues. This aspect will continue to be vital for ED2. There is an opportunity during ED2 to reduce the duplication of work between the RIIO-2 Challenge Group and the CEGs. The RIIO-2 Challenge Group should play to its strengths rather than review similar aspects already considered by the CEGs.

Overarching framework for outputs and incentives

21. We welcome views on whether the proposed output categories and incentive arrangements are appropriate for RIIO-ED2.

We believe the 3 output categories represent outcomes which consumers value and should therefore guide DNO activities.

¹⁶

<https://www.citizensadvice.org.uk/Global/CitizensAdvice/Energy/Energy%20Consultation%20responses/Citizens%20Advice%20RIIO2%20Consultation%20Response.pdf>

Whereas a wide range of DNO activities could be made to fit under 1 of the 3 outcomes, DSO functions related to system and public interest outcomes fit less well in the above framework. We have advocated further above in the responses to questions 9, 10 and 11 that the separation of the price control for DSO functions would be an appropriate solution to ensure an easier transition of such functions to non-DNO parties, if deemed efficient. As part of this separation, we have argued for the use of separate outputs, outcomes and licence conditions for the DSO functions.

We agree with Ofgem's approach to describing different outputs as licence obligations, price control deliverables and output deliver incentives, as well as keeping all options open as to the design of incentives, e.g. not ruling out relative incentives.

22. We are interested to hear if there are new elements of the services DNOs will need to deliver that should be included in the current output categories. Alternatively, we welcome views on whether these should be captured by a new output category. For these new elements, we are interested to hear how delivery of these services should be valued and measured.

We have addressed at questions 9, 10, 11, and 21 the suitability of the proposed output categories to the DSO functions that DNOs may be delivering. We believe that the current 3 output categories are broad enough to capture the BAU functions of a DNO. However, if DNOs reveal further activities as a result of responding to this consultation beyond current BAU services and the DSO functions already referred to above, we will consider whether there is a need for further output categories to accommodate these newly identified elements.

Meeting the needs of consumers and network users

23. We welcome thoughts on how to ensure that we continue to protect the interests of vulnerable consumers, particularly in light of the energy system transition.

We would point you to our published collection of individually authored essays explaining how RIIO-2 can deliver better outcomes for consumers living in vulnerable circumstances: 'A price control for everyone'¹⁷. There are many ideas

¹⁷ Citizens Advice, 'A price control for everyone', December 2018, [https://www.citizensadvice.org.uk/Global/CitizensAdvice/Energy/RIIO-2%20Vulnerability%20Essays_FINAL%20\(1\).pdf](https://www.citizensadvice.org.uk/Global/CitizensAdvice/Energy/RIIO-2%20Vulnerability%20Essays_FINAL%20(1).pdf)

within this paper from a range of stakeholders that should be considered. Here are a few examples:

- Ofgem's Stakeholder Engagement and Consumer Vulnerability incentive could be enhanced to deliver a more strategic approach to vulnerability.
- There should be a standalone vulnerability incentive under RIIO-2, one that both inspires energy networks to shine but also to collaborate and share best practice.
- Innovation funding to be linked to supporting consumers in or at extreme risk of fuel poverty.
- A more holistic approach should be considered for the Fuel Poor Network Extension Scheme.
- There should be principles that relate to the transition to the future's low-carbon economy, such as nobody should be left behind and that associated costs should be recovered fairly.

Citizens Advice also published a paper on 'Networks' Good Intentions'¹⁸ addressing whether networks were delivering on their social obligations. Our key recommendations for RIIO-2 were:

- Networks should explore collaborative and innovative approaches to delivering social obligations, when they are best-placed to deliver least-cost outcomes.
- Incentives should be designed to encourage energy networks to disseminate evidence of innovation and examples of 'what works' across the industry.
- Ofgem should encourage energy networks to work with partners to identify whole-house energy solutions, especially where opportunities exist to improve energy efficiency.
- Innovation funding and incentives should support consumers in the transition to a low-carbon future, particularly those consumers in vulnerable circumstances.

We have addressed below specific topics relating to meeting the needs of consumers with vulnerabilities.

¹⁸ Citizens Advice, 'Networks' Good Intentions, September 2016, <https://www.citizensadvice.org.uk/Global/CitizensAdvice/Energy/Networks'%20Good%20Intentions%20-Final%20Paper.pdf>

Advice provision

Given electrification of transport, potentially heat, the insufficient progress of energy efficiency interventions, and assuming current funding mechanisms for network costs persist, electricity bill payers will likely see their bills rise in the future. This makes it even more important that DNOs can effectively identify customers who are in fuel poverty or struggle to pay their bills, and refer them to sources of advice. We are aware that some DNOs already offer referrals to advice services but would like to see this offered consistently across all network areas.

As smart and flexible options become available, it may be valuable for people in fuel poverty to be given advice on opportunities to reduce their energy usage and potentially raise revenue from their flexibility capacity or generation. We would welcome DNOs to consider how best to ensure that those in fuel poverty receive this advice alongside traditional advice on managing debt or switching suppliers or tariffs to save money.

However, advice provision might have to go further in the future. When traditionally networks have focused on vulnerability to a power cut, there has been less debate about what it means to be vulnerable to climate change. Climate Just, a consortium of academics and public services, has identified several groups of people who are more vulnerable to the effects of climate change.¹⁹ For example, an elderly person may struggle to cool their home during a summer heat wave, or a 1 in 100 year flood may leave a family home without power for a week. These issues can be dealt with through various adaptation mechanisms but consumers often lack knowledge and awareness about how to do this. When it comes to designing the details of the DNO obligations, we would welcome a debate on what role DNOs could play in tackling vulnerability to climate change.

We expect the domestic aggregation market to develop in the coming years and for some form of industry self-regulation to emerge. In facilitation of flexibility markets, DNOs could assure that they only work with aggregators that subscribe to that self-regulation to help ensure that domestic customers are treated fairly and appropriately when providing flexibility.

¹⁹ <https://www.climatejust.org.uk/socially-vulnerable-groups-sensitive-climate-impacts>

Worst Served Customers

Within ED1, the Worst Served Customer use-it-or-lose-it allowance has been designed to allow DNOs to draw-down funds to assist those consumers that have particularly unreliable electricity supply. To date during ED1, there has been limited usage of these funds²⁰. In addition, the definition for a Worst Served Customer is one that has experienced 12 or more high voltage (HV) unplanned interruptions over a 3 year period, with at least 3 HV interruptions each year. We believe that it may be valuable for the ED2 price control to review the Worst Served Customer allowance and definition.

Subject to suitable stakeholder and consumer support, we believe that the needs of Worst Served Customers may need a higher priority in a more electricity-based world. Consideration should be given to identifying Worst Served Customers at the low voltage level of the network who may be currently hidden under the current definition. In addition, it may be suitable to assess whether a target to reduce numbers of Worst Served Customers may be more valuable than a use-it-or-lose-it allowance where it is effectively optional as to whether DNOs address issues for this consumer group. A target to assist Worst Served Customers could be either penalty-only or incentive based. As previously stated, stakeholder and consumer engagement would be valuable to consider the needs and any proposed solutions for this consumer demographic.

Guaranteed Standards of Performance (GSoPs)

Citizens Advice has undertaken research into networks' delivery against the GSoPs²¹. This research found that £2.5 million of compensation had failed to reach electricity consumers as companies had failed to identify and compensate them within the required time. Customers still have to claim compensation against 2 of the electricity standards.

We believe Ofgem should look to implement automatic compensation for all standards and remove the requirement for customers to submit a claim for compensation. If a DNO reasonably believes or becomes aware that it failed under a standard, it should be required to make a compensation payment. It should then use all reasonable endeavours to identify and compensate

²⁰ Ofgem ED1 Annual Report 2017-18:

https://www.ofgem.gov.uk/system/files/docs/2019/03/rriio-ed1_annual_report_2017-18.pdf

²¹ Citizens Advice research, 'Standard Issue', May 2019:

[https://www.citizensadvice.org.uk/Global/CitizensAdvice/Energy/Citizens%20Advice%20Standard%20Issue%20report%20\(1\).pdf](https://www.citizensadvice.org.uk/Global/CitizensAdvice/Energy/Citizens%20Advice%20Standard%20Issue%20report%20(1).pdf)

customers in those cases where it is not sure which households were affected, or does not have the customer's details. We acknowledge that some network companies have taken steps to implement this recommendation, and their progress should be monitored closely.

Ofgem should also extend the negative revenue adjustment to the remaining electricity standards where it does not apply. This would prevent network companies from keeping unpaid compensation.

Finally, Ofgem should use the evidence of network performance to consider the tightening or modification of some standards as was done for GDNs. This could include tightening time frames associated with particular standards, the setting of a target level for Interruptions and Customer service standards, or doing more to assist consumers in vulnerable circumstances. Performance by the majority of networks against most standards is excellent but customer expectations and speed of deliverability has moved on since the standards were written.

Maintaining a safe and resilient network

24. We welcome views on how DNOs should continue to ensure their networks are resilient, particularly in the context of the new or changing way assets are used.

A resilient network with high security of supply is a priority for an effective electricity system and to meet consumers' expectations of reliability and safety. The DNOs will need to ensure that they have prepared with the Business Plans for eventualities such as:

- Changing ways of ensuring security of supply (e.g. using flexibility or other technological solutions rather than traditional infrastructure replacement or reinforcement)
- More effective monitoring systems for their networks to identify issues sooner and to address problems, including coordination with other parties such as other DNOs, transmission companies, and the ESO
- Increasing amounts of demand side response, including at domestic level,
- Threats to IT systems due to cyber-attacks or poor processes, especially given the increasing need for virtual technology to manage the electricity system of the future
- Threats to the physical security of sites, systems and infrastructure.

- Increasing likelihood of climate-related problems (e.g. floods, heatwaves, very cold periods)
- The increased reliance on a secure electricity system to manage the homes, businesses, transport and other infrastructure of Britain. As homes and businesses become 'smarter', the need for a secure electricity supply will be paramount
- An ageing workforce and increased competition for trained personnel from competitor industries
- The need for new skills within the DNOs such as data specialists, systems designers and contracts management workers.

Security of supply

The changes in usage of electricity in homes and businesses and the inter-related reliance on systems using electricity will mean that a secure electricity supply is likely to have a heightened priority. ED1 has suitably prioritised the security of supply and used incentive measures such as the Interruptions Incentive Scheme (IIS) to encourage DNOs to reduce customer interruptions and average numbers for customer minutes lost.

Given the heightened importance of a secure supply in the future inter-connected system world, it may be valuable during the ED2 consultation and workshop process to reconsider the IIS. While the IIS does appear to have been effective during ED1 in reducing outages and total customer minutes lost, the current IIS measures only outages with a duration above three minutes. It may be valuable to ask DNOs to gather stakeholder and consumer evidence on the continued effectiveness of a measure that does not include all outages, including those of much shorter duration. It is probable that some stakeholders, e.g. consumers with vulnerabilities, or specific business system or working requirements, would put a greater value on security of supply. We are aware of the different values that consumers can place on outages (Value of Lost Load)²² and reconsideration of this measure and its usage within the DNO planning process may also be valuable in assessing security of supply measures and the cost effectiveness of planned activities.

It may also be valuable to consider whether the standards currently reached under ED1 should be locked-in and whether there is any further need to

²² Electricity North West research into Value of Lost Load: <https://www.enwl.co.uk/zero-carbon/smaller-projects/network-innovation-allowance/enwl010---value-of-lost-load-to-customers/>

incentivise these standards further. Consumer and stakeholder views will be needed to help inform on the continued importance of IIS incentives and standards and the willingness to pay for them.

Additional risks of alternative solutions

Security of supply may also be affected by the differing types of solution that may be increasingly employed to manage overall and peak demand. These alternative solutions, such as distributed energy resources provided by multiple third parties, may create additional risks to security of supply, and Business Plans will need to fully address these risks and propose effective mitigants.

Network Asset Risk Metric (NARM)

We note the proposed use of the NARM tool to assist in assessing the health and risks of network infrastructure. We understand that the NARM tool should offer a more effective mechanism to track the risks of failure of particular assets, the impact of any failure, and help to determine solutions, including non-network reinforcement or replacement options. We would support Ofgem in engaging with the industry to ensure that the NARM tool is effective in assisting DNOs in their task to maintain a resilient electricity supply.

CEG scrutiny

Resilience should remain an area that is scrutinised by CEGs, checking whether stakeholder and consumer input is sufficiently reflected in the plan, and whether changes in DNOs' Business Plans relating to security of supply issues are ambitious, sufficient and deliverable.

25. We are interested to hear stakeholder views on how DNOs should ensure their networks are resilient to physical and/or virtual threats, as well as being able to withstand the effects of adverse weather and the impacts of climate change.

As mentioned under the response to question 24, networks will need to be resilient to physical and/or virtual threats as well as manage increased risks caused by climate change impacts, such as flooding, and longer periods of heatwaves or severe cold.

We would recommend that the DNOs' Business Plans include specific reference to these resilience risks and how they will be addressed. Stakeholder and

consumer engagement will need to be undertaken to understand consumer views and to evidence support for DNOs' plans. CEGs will play a suitable role in scrutinising these aspects of the Business Plans.

Under ED1, there is a resilience allowance to address specific issues such as flood risk, tree cutting, and physical site security. According to the Ofgem ED1 Annual Report²³, it is understood that this separate allowance has driven appropriate behaviours to mitigate risks. It may be useful during the ED2 consultation and workshop process to review this separate allowance. It may be considered that companies should be addressing these resilience risks as BAU and a separate allowance is not justified. Other incentive or penalty measures (e.g. relating to security of supply, or instances of IT system failure) could substitute for a separate allowance to drive appropriate company behaviours.

26. We would also like to hear how stakeholders believe climate change mitigation and adaptation may affect network maintenance and development in the short, medium, and long term.

DNOs will need to fully incorporate planning for climate change mitigation within the Business Plans for ED2. Plans will need to incorporate the best evidence available from DFESs, sustainability, engineering, and environmental specialists, and have suitable, costed solutions to address concerns. Stakeholder and consumer input will be needed to inform Business Plans and support the planned mitigants. It may be suitable and cost-effective for DNOs to use shared resources to assess climate change issues that may affect their networks.

27. We would like to hear views on how we ensure DNOs remain resilient to the challenges presented by an ageing and changing workforce.

DNOs are facing challenges with respect to an ageing workforce and competition from other industries for trained personnel. It is important that workforce resilience is given a high priority by companies to ensure that the networks can continue to provide a secure and quality electricity system and meet future requirements. Historically, companies have focused on attracting engineers and young people who would stay with the company for many years. Going forward, companies need to show how they are able to attract people from many different backgrounds, and workers who are mid-career, and might not have thought about working for a network company. We support the move to include a section within the Business Plan which requires companies to describe their

²³ Ofgem ED1 Annual Report 2017-18:
https://www.ofgem.gov.uk/system/files/docs/2019/03/rriio-ed1_annual_report_2017-18.pdf

approach and planned activities to ensure workforce needs of the company are met. Workforce resilience planning, as with other resilience issues, would be a suitable area for the CEG to scrutinise.

The consultation paper notes that the majority of DNOs supported the introduction of a workforce resilience measure, however, it is not clear how this measure could be set. Simplistic age profiles of workers or numbers of apprentices, for example, may not capture the range of future workforce resilience issues facing the DNOs. The companies may need workers with different skills compared to the past to build the systems and control management processes to manage the DSO functions, for instance. These factors may not easily be accommodated within a simple workforce measure. It would be appropriate to canvass views from the DNOs and other stakeholders during the ED2 consultation and workshop process to capture suggested workforce resilience measures and then consult upon their value. We would see value in measuring a number of metrics across DNOs to generate comparative data which is currently missing.

Delivering an environmentally sustainable network

28. We welcome views on how DNOs should work to minimise the impact of what they do on the environment and facilitate the transition to a low carbon energy system. We are particularly interested in the implications of the government's updated target of netzero emissions by 2050.

Please also see our answer to questions 2 and 3 above.

DNOs have a direct impact upon the environment from their own activities including emissions of greenhouse gases (for example carbon emissions and SF6) that are generated from their use of equipment, from occupying premises and through transport usage. The network companies also have an environmental impact on the land upon which their distribution infrastructure stands as well as wider impacts through the use of non-biodegradable products such as plastics. DNOs, through their relationship with the land and the communities which they serve, as well as their superior knowledge of energy usage, could become exemplars in the field of reducing environmental impacts. We believe that DNOs' Business Plans should reflect the drive to achieve a 2050 net zero target and incorporate other environmental improvements, reflecting stakeholder and consumer input.

We recommend that the ED2 framework should be aligned with the RII0-2 framework established for the electricity transmission industry including requirements to:

- Have a section within the Business Plan describing their Environmental Impact planning and the targets that they will be working towards during ED2
- Regular periodic environmental reporting, including progress to targets on improving a company's:
 - Business Carbon Footprint
 - Electricity losses
 - SF6 emissions and other Installation Interruption Gas emissions
 - Negative effects on land including how they might promote positive improvements to habitats (e.g. increased biodiversity or planting of carbon dioxide-absorbing trees) or reduce impacts such as noise or air pollution from their streetwork activities
- Eliminate SF6 from their networks through natural end of life replacement or active interventions. Viable alternatives are available for HV and LV switchgear, although these gases also have an environmental impact, which should be monitored and targeted for reduction. Alternatives for replacing or reinforcing a network's infrastructure (e.g. use of flexibility or the use of an active network management system) should be given strong consideration in Cost/Benefit Analyses where environmental improvements may result.

Energy efficiency promotion

See also our response to question 3.

Some DNOs have proposed becoming advisers to businesses, local authorities and communities to help them to adopt more energy efficient and other environmentally-beneficial technologies or services. The price control may be a mechanism to support this aspect of DNOs' work, however, there will need to be strong stakeholder and consumer support for this new activity for DNOs. There will also need to be consideration on any effects on fair competition in delivering this form of advice or in the distribution of funding to deliver energy efficiency measures. It is recommended that wide consultation with stakeholders should be undertaken to identify the implications of DNOs undertaking this new activity and to assess the benefits and drawbacks of the network companies operating in this field.

29. We also welcome views on what this may mean for the type of activities networks undertake, how these may be funded, as well as the outputs and/or incentives they should be exposed to.

We believe that there will likely need for additional funding or incentives to encourage DNOs to eliminate SF6 from their systems sooner than the asset life dictates. This does not necessarily mean that innovation funding is required as viable alternatives exist, however, these alternatives may currently cost more than the equivalent SF6 solution.

As responsible businesses within their communities, we believe that DNOs should be working towards reducing their own day to day environmental impact. This might involve fleet replacement with low carbon alternatives. DNOs should also be working towards reduction of visual, noise and air pollution at streetwork sites. These elements could be targeted as price control deliverables, or via incentive mechanisms. We would welcome further consultation on the likely best mechanisms to achieve reduction in DNOs' environmental impact including input from DNOs.

30. Finally, we are keen to understand how DNOs' performance should be measured, and how we should assess the value that consumers place on the provision of these services and activities.

DNOs' Business Plans should be driven and supported by their stakeholders, consumers, and customers. Environmental and sustainability-focused activities should be informed by the value that these stakeholders, consumers, and customers place on the provision of these services and activities. We also believe that there is value in looking to external measures to assess an environmentally sustainable network, such as using established measures such as the carbon price, or the value of a statistical life with regards to avoiding air pollution. We would welcome further consultation upon these topics in the continuing ED2 consultation process.

Enabling whole system solutions

31. We welcome views on how RIIO-ED2 can best capture the benefit of whole systems solutions. We are also interested in views on how these benefits should be measured.

We have addressed some issues relating to whole systems solutions at question 3 which is repeated below for ease of review:

Decarbonisation will require a wide range of solutions that cross sectors such as heat and transport as well as the electricity industry. The DNOs will increasingly need to work closely with others in the gas transmission and distribution networks, the electricity transmission companies, and with the Electricity System Operator. Local drivers of decarbonisation will also be important to achieve the net zero goal such as devolved governments, local councils, third party flexibility and aggregator companies, and sustainability and community groups. The ED2 price control will need to ensure that DNOs are suitably encouraged to work holistically across these sectors and agencies. Mechanisms to incentivise whole system solutions could include:

- Recognition within a Business Plan Incentive that the DNO has fully considered and incorporated whole systems thinking.
- Amendments to Cost/Benefit Analyses to include partial or wholly non-DNO solutions.
- Sharing of incentives or innovation funds to include potentially multiple DNOs, non-DNO participants (such as the ESO), and non-network third parties to foster competitive and innovative solutions.
- Measures of reinforcement or replacement avoided.
- Extent of use of flexibility and other alternatives.
- Extent of energy efficiency measures delivered and their impact.
- Extent of green energy accommodated at distribution level.

We welcome further consideration of how to incentivise whole systems solutions within the next stage of the ED2 consultation process in the Sector Specific Methodology, as well as how to ensure consistency across the sectors.

32. We further welcome stakeholders' opinions on whether the electricity distribution sector's approach to whole systems should be different from the other sectors and, if so, why.

The DNOs have a particularly important role to play within whole systems solutions given their current role in facilitating DSO functions. However, we do not believe that the electricity distribution sector should have a different approach to whole systems compared to the other sectors. All sectors in the energy system, whether electricity or gas transmission, gas distribution, electricity distribution, or the ESO, have a responsibility to work towards holistic solutions that will lead to a cost-efficient, lower demand, and lower carbon energy system.

Managing uncertainty

33. We welcome views on how we should manage the uncertainty associated with forecasting allowances, and whether there are any mechanisms we could or should consider in helping to manage this uncertainty.

There are likely to be increased difficulties in setting allowances for ED2 given the uncertain timeline for decarbonisation of heat and the uptake of electric vehicles, the continuing evolution of DSO functions, and the use of more novel non-network solutions to manage the network. There is also the potential for cost-reduction within the electricity system due to the development of aggregation and other distributed energy resources at distribution level, the potential for higher uptake of energy efficiency measures, and the increase in demand-reducing products and services.

We have noted these increased uncertainties at questions 6 to 11 and suggested a number of potential mitigants. The need for a flexible and responsive price control process will be paramount to support DNOs to have the funds that they require to meet the needs of consumers, while also protecting consumers from the risk of stranded assets and/or an overgenerous settlement. As explained further above at questions 6 to 11, we would recommend the use of reopeners as the primary mechanism to address uncertainties during the ED2 price control period.

34. We seek views on the use of indexation, particularly on any adjustments for labour and construction cost inflation.

Indexation offers a readily-understood mechanism to manage uncertainty. Where specific cost profiles may diverge from the wider inflation measure, the use of indexation for industry-specific cost elements appears to be an appropriate means of addressing uncertainty.

The development of DSO functions may generate new lines of cost that the DNOs had not previously used. These could include the costs of different types of labour such as data scientists, designers for interoperable systems, or staff to manage complex third party contracts. Indexation of these new cost elements may be appropriate, where available.

35. We welcome views on our approach to highly anticipatory investment projects. We are interested to hear whether stakeholders would suggest additional processes or regimes for facilitating such investments that support the energy system transition whilst protecting consumers from potentially inefficient investments.

We believe that requesting DNOs to identify highly anticipatory projects within their Business Plans is valuable including the requirement for DNOs to justify the need for such an investment along with addressing how they should be treated within the price control. We note the intention of Ofgem to provide more detail on how highly anticipatory projects should be defined in the Sector Specific Methodology.

The main risk associated with highly anticipatory projects is the incidence of stranded assets that may need to be paid for, unnecessarily, by consumers for decades. We have considered the issue of anticipatory investments in the responses to the questions at 6, 7 and 8 where we have argued that a rapid and responsive reopener system - with a level of scrutiny similar to the business planning stage, but proportionate to the bid levels - may offer a less risky alternative. This may accommodate the high levels of uncertainty surrounding demand profiles, costs, and the best alternatives for investment that may be available in the future. A separate independent review body for anticipatory investments may also offer some comfort in these decisions (and would provide a welcome layer of scrutiny in reopeners). It does not appear suitable for consumers to bear high levels of shared risk given the extent of uncertainty facing the industry.

36. We welcome views on the type of issues that should be considered through an interinstitutional group.

At question 7, we have responded that there may be value in using an independent review body to assess anticipatory or strategic investment to provide further assurance that the decisions are justified and well costed. It may be valuable for such a body or group to assist in providing clarity on cost elements that are less well known, such as costs for data scientists, interoperable system designers, contracts staff, or for active network management system costs. The body or group could also act to verify the validity of DFESs, the risks of climate change to the system or other issues that are generic to the DNO industry.

37. We invite stakeholders to advise what type of expenditure they believe should be subject to alternative arrangements for sharing risk, and what these arrangements may look like.

The level of uncertainties during the ED2 process appears higher than in the prior ED1 price control period as has previously been described. The current sharing mechanisms for incentives such as the Totex Incentive Mechanism were there to drive efficiency cost savings and share some of the costs where there was some unexpected overspend. In the forthcoming environment, where there are increased uncertainties on the level of investment needed, the cost profiles of alternative options to replacement or reinforcement, whether third parties may deliver some elements, and the costs for DSO functions, it would appear fairer for both companies and the consumer to have a more certain outcome. As such, we have advocated for the use of more reopener mechanisms to cope with these uncertain costs. As noted previously in this response, the reopener mechanisms will need to be rapid and responsive to meet the needs of companies in maintaining their networks, and building services and infrastructure for the future.

With highly anticipatory investments, we would want the risk to consumers limited and are open to look at different regimes to achieve this. There may be scope to have private investors or local authorities carry some financial risks if they will benefit from or if they trigger, for example, reinforcement. Especially with decarbonisation projects, a fundamental question is whether some costs should be borne by taxpayers rather than electricity bill payers. As such, a wider debate should be encouraged upon this aspect of network costs in addition to the current Significant Code Review on Access and Forward-Looking Charges.

Driving efficiency through innovation and competition

38. We welcome views on the proposed innovation stimulus. We are interested to hear views on the types of projects that should be funded through either the NIA funding or a new funding pot.

We support Ofgem's approach that innovation should be at the heart of what network companies do, and that DNOs should be undertaking more innovation as BAU activities. Additional large strategic innovation challenges are proposed to be met via a new funding pot replacing the Network Innovation Competition. We support the move to this new funding arrangement which should support

whole systems thinking and holistic, multi-party solutions (including permitting funding to non-network parties).

We further recognise the value of including costs of the roll out of proven innovation solutions within the Business Plan Incentive rather than as a separate Innovation Roll Out Mechanism (IRM). However, we have continued concerns regarding the roll out of proven innovation projects whether the roll out would be funded via the IRM or a Business Plan Incentive. We have noted that few projects funded under innovation funding have been further supported to widespread roll out via the IRM in ED1. There appears to be a risk, therefore, that successful innovation projects, primarily funded by consumers, could conclude without the benefits of these projects being fed back into the electricity system. We therefore would ask for Ofgem to consider the methods under ED2 that would better evaluate concluded innovation projects under ED1 and ED2 to capture the best solutions. Those innovations with proven value could be incentivised or mandated to be rolled out across DNOs, thereby ensuring that the benefits of past innovation funding are secured within the distribution system. Assessment of non-DNO-generated innovative solutions should also be considered, not those solely driven via DNOs, and should have the same reporting requirements so that learnings can be shared in the same way.

ED2 reopener mechanisms could be used to support roll out of such proven innovations if discovered during the ED2 price control period, with funding potentially available to non-DNOs to implement solutions, where deemed most efficient or cost effective.

39. How can the benefits of the innovation stimulus be maximised by supporting schemes proposed by non-network parties?

See also answer to question 38. We believe that innovation funding should be available to non-network parties, or partnerships of multiple parties that may comprise network and non-network parties. For transparency and neutral decision making, it may be valuable to use an independent body to assist assessing innovation funding allocations.

40. We also welcome views on our proposals for the different competition models in RIIO-ED2, and what, if any, criteria should be set out for the use of early or late stage competition models.

We agree that the extension of early and late models of competition to electricity distribution should provide better value for money for consumers. We note that Ofgem will introduce new models for ED2 for competition but would point out that it may be useful to have a separation of DNO BAU competition elements and those for DSO functions, although we await further details on proposals, including whether DSO functions are to be separated within the price control. We have further described our view on separating DNO BAU activities and DSO functions elsewhere in this response.

41. We also seek input from stakeholders on how native competition obligations and best practices can be used to ensure the best outcomes for consumers and to drive changes in the role of the networks in a transforming energy system.

Native competition (i.e. those competitions run by network companies within the price control framework under the Totex Incentive Mechanism (TIM)), is useful to drive down costs and gain efficiencies within the companies to the benefit of consumers via the TIM sharing factor. However, an extension of more explicit competition requirements may be useful to further drive down costs in the system or consider other solutions. The incorporation of DSO functions, including the tendering of alternative solutions, such as flexibility, may require a different approach to decision-making, including the potential for a separate, independent competition review body.

We note that there are review mechanisms for projects of high value in early competition, however, we believe that future competition review mechanisms may require a lower value threshold and capture a wider set of investment option decisions. Any independent review body will need to have a consistent and rapid delivery to meet the needs of a fast-moving and evolving electricity distribution system looking to incorporate alternative solutions. We do not support CEGs as the bodies to run the competition process given their different remit and the potential loss of independence in scrutiny of network companies' business planning.

Forecasting and scenarios

42. We welcome views on our approach to planning, forecasting and scenarios for RIIO-ED2. In particular, do stakeholders have other suggestions as to how we can best manage forecasting risk for consumers?

The consistent view of the future (ENA Common Scenario) should be a basis for business planning by DNOs, as proposed by the ED2 Open Letter consultation. It would be valuable for the consistent view of the future to be updated for ED2 to reflect changes in government policies and new information about demand, generation and local drivers for decarbonisation, for example.

There are considerable regional differences that will drive divergence in DNO Business Plans from the Common Scenario. Each DNO produces Distribution Future Energy Scenarios (DFESs) that show existing DNO infrastructure and how demand and generation changes in that particular area may impact the future needs of the licence area. Regional stakeholder preferences and goals (e.g. local or devolved government net zero targets, or consumer preference for accelerated or slowed reduction in carbon emissions) will also mean that DNO Business Plans will need to be responsive to these consumer drivers with resultant further divergence from the Common Scenario.

We have already addressed at question 6 how we view DFESs and their importance in business planning. Given that the DFES is one of the major reasons why DNO Business Plans will not track the Common Scenario, we would ask for increased independent scrutiny of the DFES process. If the assumptions or conclusions within DFESs are not valid, there will be likely consequent impacts for the price control, including incorrect allocations of funding. As can be seen under ED1²⁴, incorrect forecasting of demand, for example, can result in underspends for companies which are not wholly returned to consumers. Companies can unduly benefit from forecast errors.

No forecast, however carefully constructed, will exactly match future demand needs and therefore Business Plans and the ED2 price control will need to be sufficiently flexible to allow for future demand trends that may diverge significantly from expectations. Responsive reopener mechanisms offer a solution to manage forecasting risk. We have addressed the use of reopener mechanisms to accommodate uncertainties at question 7.

²⁴ Ofgem, ED1 Annual Report 2017-18:
https://www.ofgem.gov.uk/system/files/docs/2019/03/rriio-ed1_annual_report_2017-18.pdf

Business plan and totex incentives

43. We welcome views on our proposal to remove the early settlement process for RIIO-ED2, instead focusing on alternative mechanisms to receive high-quality and ambitious business plans.

We support the removal of the early settlement process for ED2 given the compression of timetable to appropriately design and review Business Plans under a fast-track process. As well as Ofgem, the CEGs and the RIIO-2 Challenge Group will have further time to assess individual Business Plans and be able to compare them in a one-track system with a longer timeline.

44. We also welcome views on our proposals to use the Business Plan Incentive and the confidence-dependent incentive rate arrangements for RIIO-ED2. In line with this, we are interested to hear stakeholder views on the range that should be used for both of these.

Given the outcomes from the IQI approach, we are happy to support an alternative approach. However, our key concern at this stage is the apparent subjectivity associated with the assessment of 'confidence', which is currently undefined. One advantage of the IQI approach was that it was largely objective and mathematically designed – Ofgem should work to ensure that the assessment 'confidence' retains some of these benefits. Regarding the potential range that should be used, the current business plan assessment process for GD2 – if evaluated properly – will provide helpful evidence and a steer on the most appropriate range.

It appears to us that the Business Plan Incentive will reward companies for a great number and range of deliverables and plan attributes. It therefore needs to offer an adequate reward that companies are actually incentivised to put effort into all those aspects. From what we have observed of the GDNs and transmission companies, the prospective reward of +/- 2% of final determination totex has driven companies to work hard on enhanced engagement and producing a quality plan.

Fair returns and financeability

45. We welcome stakeholder views on our proposals to introduce measures to enable network companies to finance their activities whilst ensuring they receive a fair return.

We would welcome further clarification from Ofgem regarding its comments on changes in the energy sector and risk exposure (p. 26). Whilst we support the intention to ensure investors and consumers are not exposed to higher risks, there are some aspects of the ED2 price control - such as anticipatory investment - that may introduce additional risk. It would be helpful for Ofgem to clarify which areas of the ED2 price control it sees as potentially introducing more risk to either investors or consumers, how the balance of risk will be shared and what measures are being considered to minimise these risks.

Beyond this, we remain supportive of Ofgem's intentions to enable investors in ED companies to receive a fair return on their investment whilst delivering an excellent quality service to consumers. One of the biggest challenges for Ofgem is to achieve this whilst ensuring ED companies are working to a clear and realistic net zero roadmap (both internally, and in a wider sectoral facilitation role).

As we mentioned within our response to the RIIO-2 Sector Specific Methodology consultation²⁵, we welcome Ofgem's focus on reducing the cost of capital for RIIO-2 (and ED2). Some network companies (such as Western Power Distribution) have made voluntary returns back to consumers for the overcharging that has taken place during RIIO-1. Although these companies have not returned all of the money identified through our analysis²⁶, the returns made so far are the right thing to do. There are still a number of companies who have taken no action. We think that Ofgem's proposals should include a consideration of a company's approach to voluntary returns, and specifically any voluntary returns made in the RIIO-1 period, when determining the settlement that the DNOs are given. There should be more confidence in those companies that have taken action and returned money to consumers. Ofwat is taking this approach in PR19 in assessing water companies who have made voluntary returns.²⁷

²⁵ Citizens Advice response to the RIIO-2 Sector Specific Methodology consultation: <https://www.citizensadvice.org.uk/Global/CitizensAdvice/Energy/Energy%20Consultation%20responses/2Citizens%20Advice%20-%20RIIO2%20sector%20specific%20response%20-%20March%202019.pdf>

²⁶ Citizens Advice, 'Monopoly Money: How consumers overpaid by billions', May 2019: <https://www.citizensadvice.org.uk/Global/CitizensAdvice/Consumer%20publications/Monopoly%20Money%20-%20How%20consumers%20overpaid%20by%20billions.pdf>

²⁷Pages 9 and 10:

www.ofwat.gov.uk/wp-content/uploads/2019/01/PR19-initial-assessment-of-plans-Summary-of-t est-area-assessment.pdf

46. We are interested to hear from stakeholders on how they believe we should set allowances for the cost of debt, particularly around the method of recalibrating the index.

We have long been supporters of the move to the full indexation of debt costs, due to the increased transparency and trackability that enables whilst removing the risk of forecast errors. We firmly believe that consumers should only pay for efficient costs and so support the proposal to retain debt indexation for ED2. The cost of debt index for ED companies is in a multi-period process of adjustment (i.e. the trombone), which in our current view should be allowed to run its course and the processes undertaken in ED1 continued. Otherwise, alternative actions could unfairly affect a major stakeholder group, including consumers and operators.

47. We also welcome views on our proposed approach to setting allowances for the cost of equity, as well as our proposal to move away from RPI.

We welcome Ofgem's general approach for setting the cost of equity, as well as the intentions to move to CPI(H), rather than continuing with RPI. Our view is that this latter shift should be conducted completely and at one point in time (i.e. rather than a staggered or blended approach), at the start of the ED2 price control. This will enable the reductions in the cost of capital to soften the short-term impact on consumers.

48. Finally, we would like to hear stakeholders' views on our proposed introduction of a 'sculpted sharing factor' in instances of high out- or under-performance, or whether an alternative mechanism could be more effective.

We appreciate Ofgem's desire to prevent unfair levels of returns for network operators, as is happening in RII0-1. As stated in previous consultation responses, we are not opposed to introducing a sculpted sharing factor in instances of high out or underperformance. We look forward to further discussions regarding the details of how this mechanism should be best designed, including functionality and calibration. More broadly, and in the long term, we consider it in consumers' interests for continuing rewards for outperformance to be earned at a declining rate, rather than reward levels converging at a de-facto cap. True outperformance should be an ambition, not an expectation, both at the company level and across the sector.

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