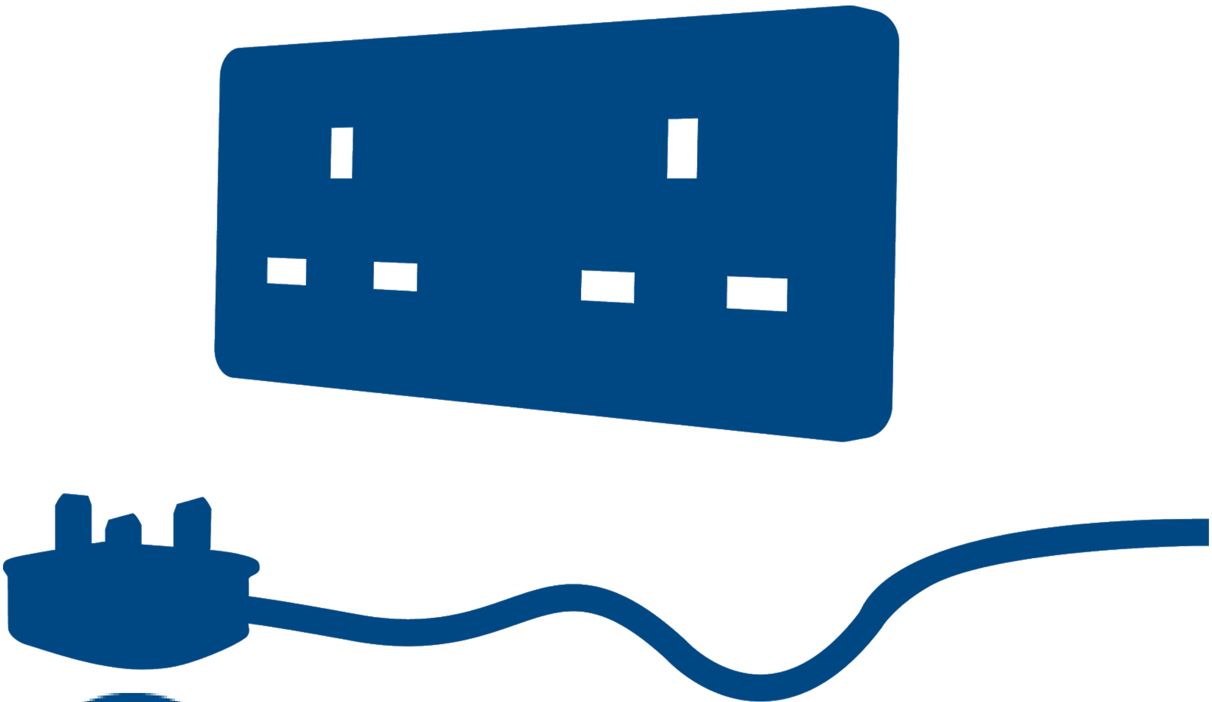
Ofgem RIIO-ED2 Methodology consultation

Executive Summary and Overview Section

Citizens Advice submission

October 2020



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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 (GB).

This submission responds to the Ofgem RIIO-ED2 Methodology Consultation[1] which relates to the price control for 2023-28 for the 6 Distribution Network Operator (DNO) companies of Great Britain (GB). The RIIO-ED2 (ED2) Sector

[1] Ofgem, RIIO-ED2 Methodology Consultation, July 2020

Specific Methodology Consultation (SSMC) invites views regarding Ofgem's current intentions and ideas for the DNO price control.

This is the first of 4 submissions in response to the ED2 SSMC. We would advise reading the Executive Summary and General Comments sections below before reading the second, third and fourth submissions, as the first submission frames the later question responses.

Our response draws on input from Europe Economics, HMK Advisory Ltd and Zephyre Ltd.

Executive Summary

The electricity distribution network companies that deliver electricity through their wires to our homes and businesses provide an essential service. The DNOs are custodians of national infrastructure and have a privileged role in serving GB's consumers.

Ofgem has a series of key tasks for the ED2 price control and must do them well to ensure that the DNOs are able to do their job in maintaining the electricity network and developing it to meet the needs of Net Zero. We believe that Ofgem will need to:

- Ensure that this price control avoids some of the errors of ED1 and cuts over-generous funding, particularly for cost of capital
- Show how consumer evidence has been used in their decisions. The previous RIIO-2 price control hasn't shown how Ofgem used the extensive stakeholder input that built the company's Business Plans
- Put in the building blocks and a timeline to gather evidence to determine whether Distribution System Operation (DSO) functions, which make the system smarter and more cost-effective, should be separate from the DNOs to avoid potential conflict problems
- Foster better collaboration between the DNOs, particularly for the newer DSO functions, to ensure that the electricity system is cost-effective and duplication of effort is avoided
- Only provide funding for strategic investments, which are the investments made when the DNOs are developing the network much earlier than

normal, using a high degree of scrutiny using robust forecasting evidence and mechanisms to minimise over-spending

- Take on board the impacts that COVID-19 might have on the future demand for electricity and the ability of people to fund new investment
- Maintain focus on the needs of those with vulnerabilities that may require additional support from their DNOs, especially in the transition to a new electricity system

ED2 is on track to meet Citizens Advice's RIIO-2 principles

Ofgem has taken significant steps in the ED2 price control towards meeting our 5 principles[2]. These 5 principles were published in 2018, to ensure that the ED2 price control would meet the needs of consumers. The principles were:

1. To address excess company profits
2. Return company unspent money to consumers
3. Listen to consumers
4. Improve company transparency
5. Support for low carbon initiatives and vulnerable consumers

We think Ofgem is broadly on track to deliver against these principles. We have outlined in this response how we believe Ofgem has met the principles for the electricity distribution sector. We have also set out where we feel Ofgem has made the right decisions, and provide our recommendations for other areas so that the ED2 price control will be more cost-effective, better protect customers in vulnerable circumstances, and ensure that the energy network companies play a key role in the Net Zero transition.

Correcting the errors of ED1

It is essential that monopoly networks are value for money for consumers, and we don't think that Ofgem got it right for ED1. In the ED1 price control, companies have consistently earned higher returns than were expected by Ofgem at the outset[3]. In the latest Annual Report figures, DNO groups' forecast Return on Regulatory Equity (RoRE) ranges between 7.9% and 10.7% over the

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[2] Citizens Advice, 'Will Ofgem's next price control really deliver for consumers?', August 2018. We set out in our recent response to the RIIO-2 draft determinations our views on whether Ofgem had met the 5 principles for that price control. Citizens Advice response to RIIO-2 Draft Determinations for Transmission, Gas Distribution and Electricity System Operator, September 2020

[3] Ofgem, RIIO-ED2 Impact Assessment, July 2020

RIIO-ED1 period[4]. This is due in part to underspending on totex allowances. Particularly problematic was the opportunity to underspend on total load related costs. The underspend was 39%. Expenditure on network reinforcement is around 47% less than the allowance. This is a concerning trend, when overall, there has been a £259 million overspend on addressing network faults that can cause consumer detriment. Alongside underspend, our analysis has shown that the calculations that Ofgem have used for funding companies for their cost of capital were wrong.

Although we think the CMA should have gone further, its interim findings for the PR19 appeal show that for the period 2019-2022 the cost of capital will be far lower than the generous rates that ED1 allows. DNOs will benefit from the difference, and we think Ofgem should take this into account (including where companies have returned money to consumers) when considering the shape of the ED2 framework and ultimately their determinations for companies. We have addressed these points in detail further in the response, and in answers to questions in the Annex 3 Finance section.

Ensuring excess funding is returned to consumers

The next price control needs to ensure that companies don't keep funding that they have not needed, or where a company benefited from a windfall gain as opposed to their efforts to drive efficiencies. We therefore support the various mechanisms within the ED2 proposals to clawback funds for non- or under-delivery of projects, to set sharing factors in a way that should better share efficiency savings with consumers, and the use of Price Control Deliverables to set expected outputs as well as the means to recover unspent funds. The use of re-opener mechanisms, such as the Net Zero re-opener, also gives more scrutiny of decisions for uncertain investments to ensure that only the funds needed are awarded.

Use of Consumer Evidence

A key area for ED2 will be for Ofgem to communicate how consumer evidence has been used in its decisions. For the RIIO-2 draft determinations, we thought that there was a lack of transparency in decision-making which could risk stakeholder commitment to ongoing enhanced engagement in ED2 including Business Plan development. We want to see this addressed in the ED2 draft

[4] Ofgem, Network Performance Summary 2018-2019, 2019

determinations to make it clear how consumer evidence has been used to reach decisions on the Business Plan submissions.

We encourage Ofgem to explicitly consider how to respond to the uncertain implications of the COVID-19 pandemic for consumers and how these may affect the consumer evidence gathered by companies. In our view there needs to be a robust, evidence-based approach set out by the submission of ED2 Business Plans reflecting the important changes in people's situations caused by COVID-19. Both Ofgem and regulated companies need to consider the possible scenarios for the duration and economic impact of the pandemic and focus on the potential range of impacts.

Re-openers or funding for strategic investment in ED2 should have a strong evidence base considering willingness to pay alongside other consumer evidence. Projects may potentially need to be cancelled or rescheduled based on new information, and there may be a need to rebalance bill payments from current to future consumers or to introduce other mitigations to support some consumers in financial difficulties.

Distribution System Operation (DSO) transition

DNOs are taking on new functions as the energy system transitions. They will have to be able to better forecast capacity and demand for their networks and manage them in a more sophisticated way while maintaining reliability. This will mean that they have to build systems using enhanced data about their networks. They will need to actively manage peaks and troughs in demand through using flexibility resources from third parties to drive down costs, and use these as an alternative to traditional and often expensive infrastructure building. The markets to ensure that these new alternatives are as cost-effective and competitive as possible will also need to be facilitated by the networks, promoting transparency of opportunities and establishing standardisation of contracts.

ED2 needs to make sure that these DSO functions are established robustly, cheaply, and as rapidly as possible to enable the distribution-level electricity network to operate smarter and cost-efficiently for consumers. Progress towards Net Zero could be impacted if the DSO transition is not done well and it could cost consumers more than it should. We welcome the new minimum requirements that Ofgem has laid down for these DSO functions, but we don't think that Ofgem has yet done enough to ensure that there is transparency of the costs for these new lines of expenditure. We are asking for separation of revenues, costs and incentives for DSO functions. While we understand the need to keep the DSO functions within the DNOs while these functions are established, we believe that there is a need to separate out the DNO and DSO activities to examine whether these companies are providing value for money and help address concerns relating to conflicts of interest.

Separation of activity will also make it much simpler to evaluate the splitting away of the DSO functions, as has happened with the Electricity System Operator (ESO) at the transmission level. We think it's important to retain this option if needed to avoid potential or actual conflicts between the DNO and DSO roles. We know that there is a cost in itself to undertake this separation of activity within the DNOs, but we believe that there are sufficient potential benefits. We think that **Ofgem needs to put in the building blocks now to gather evidence for the assessment of any future formal or legal separation for the DSO functions** and set a clear timeline for this assessment so that companies and stakeholders know what is intended.

We think that annual monitoring for these new and evolving DSO functions is essential to drive progress and consistency. Leaving the reviews to mid-price control and the endpoint is not going to do enough to provide the impetus and best practice learning that is needed to deliver benefits for consumers.

The ED2 price control will need to facilitate progress towards Net Zero and facilitate the uptake of LCTs, local generation, and flexibility resources. It will be a challenge, to ensure companies are not overpaid to provide investments that are underused (known as stranded assets). Devolved governments, and regional and local authorities' actions towards meeting Net Zero mean that local demand may vary from national forecasts such as the National Grid ESO Future Energy Scenarios[5]. DNOs need to produce local forecasting, but despite ongoing industry efforts to improve the process the lack of consistency in how the DNOs' Distribution Future Energy Scenarios (DFESs) are put together coupled with a lack of scrutiny by Ofgem is a concern. **We think that Ofgem should be cautious and only provide funding for strategic investments in baseline funding where DNO forecasting can be assured** or to use other mechanisms to give the appropriate level of scrutiny.

[5] National Grid Electricity System Operator, Future Energy Scenarios 2020

The 6 DNO companies manage 14 different licence areas across GB. It is vital that these companies work collaboratively to make best use of innovations, systems, personnel, and use consistent metrics and methodologies. Doing this would help the electricity distribution sector to provide the most up to date and efficient system at the lowest cost for consumers. We believe that there is more that the DNOs could be doing to collaborate around practices and systems, particularly in their new roles to deliver DSO functions. It is clear that there are already efficiencies being generated through unified processes by individual companies where they manage multiple licence areas. Further efficiencies could be wrought through greater collaboration in developing collaborative DSO systems and processes rather than each company or licence area establishing separate and costly operations. Where appropriate, **we recommend that Ofgem considers how best to foster this collaboration and how to incentivise the companies to deliver cost efficiencies across the DNOs.**

Meeting the challenges of an uncertain environment

The electricity distribution industry faces a great deal of uncertainty in the coming years as the country and its citizens determine how to respond to the Net Zero agenda. We will see the uptake of low carbon technologies (LCTs) such as electric vehicles and heat pumps but the timing and number of these changes will depend on many factors outside the industry's control such as national or regional policy initiatives, consumer responsiveness and the economic environment.

While actions to meet the Net Zero target will affect the whole electricity system, the impacts for managing the lower voltage distribution level networks are likely to be more pronounced. This is because consumers will adapt differently across GB creating regional and local variations. The situation is further compounded due to other uncertainties. The emerging impacts of the COVID-19 pandemic may affect the affordability of consumers funding new projects, or dampen expected energy demand. The Access and Forward Looking Charges Significant Code Review (Access SCR) is likely to change the number of connections for LCTs, local generation, or other flexibility resources (like battery storage) at the distribution level. The ED2 price control will have to be smart and flexible enough to manage these uncertainties and the DNOs will need to become more effective forecasters for their networks and be able to provide robust evidence to prove where funding is needed.

No one left behind - ensuring that those in vulnerable situations get the services that they need

Despite all of these changes due to happen in ED2, DNOs should not lose their focus on those that can be most seriously impacted by the electricity distribution system. People with vulnerabilities, such as those on low incomes or dependent upon electricity for medical purposes, can be seriously impacted by power cuts. It is right that the DNOs continue their maintenance of the systems to focus on reliability and provide appropriate services in the event of an outage, particularly for those people in vulnerable circumstances. We are largely satisfied with the ED2 proposals to support those most affected by a failing in the electricity system, but we have made recommendations to ensure that people that may be affected by the DSO decisions are not left behind and suffer detriment. We are asking for the DNOs to include distributional and inclusivity impacts within their DSO Strategies to ensure that they make the best plans which take account of everyone's needs.

Impact of COVID-19

The COVID-19 pandemic struck GB in Spring 2020. We appreciate that the implications from COVID-19 are still uncertain but it's already clear that issues around consumer affordability have become acute.

One in 9 people, the equivalent of 6 million people nationwide, has fallen behind on a household bill because of the coronavirus pandemic[6] [7]. Ofgem's overall approach to baseline funding within the RIIO-2 GD & T price control appears to factor in the likely dampening in consumer willingness to pay due to COVID-19. In ED2 the scale of the COVID-19 impact should be reflected explicitly, not just in more efficient baseline funding, but across the course of the price control proposal. COVID-19 is also having a wider energy system impact driven by more home working, depressed demand for energy on the system overall and new demand profiles[8]. The costs of responding to these changes will be borne by consumers,[9] alongside higher unemployment and redundancies, increasing consumer debt, and general pressure on household incomes.

[6] Citizens Advice, Excess debts - who has fallen behind on their household bills due to coronavirus?, September 2020
[7]Citizens Advice, Six million fall behind on bills because of coronavirus, August 2020.
[8] National Grid ESO, The actions we're taking to manage reduced demand for electricity this summer, May 2020.
[9]Balancing costs are up to £718 million over March to July, which is a 39% year on year increase Ofgem, Open letter our review high balancing costs during spring and summer 2020, 2020.

These issues could have implications for the operations of networks over the period of the price control. For example, they could potentially lead to less need to invest in some areas due to demand changes, reduced consumer willingness to pay for new projects, and potentially less ability or appetite for consumers to support extensive infrastructure expansion. In this context**, it will be vital for Ofgem to consider the ongoing impact on the price control.**

General comments

How well does ED2 meet our 5 principles:

Principle 1: Profits are lower than the previous price control, to more accurately reflect the relative low risk for investors in this sector.

We have advocated over numerous regulatory price controls in multiple sectors to reduce the mistakes that regulators have made in calculating the returns to network companies and have produced a number of reports presenting our research on this important topic:

- Redetermining water, July 2020[10]
- CMA Ofwat Price Determinations appeal (water price control) initial submission, May 2020[11]
- Monopoly Money: How consumers overpaid by billions, May 2019[12]
- Energy Consumers' Missing Billions, May 2017[13]

In ED1, companies have consistently earned higher returns than were expected by Ofgem at the outset of the price control[14]. DNOs have kept a substantial proportion of unspent funds under the Totex Incentive Mechanism (TIM) which aimed to incentivise efficient solutions through innovation. Ofgem's impact assessment[15] shows that some DNOs have earned significant returns through totex outperformance, primarily due to underspending on network

[10] Citizens Advice, 'Redetermining water', July 2020.
[11] Citizens Advice, Initial submission to CMA Ofwat Price Determinations appeal (Water), May 2020.
[12] Citizens Advice, 'Monopoly Money: How consumers overpaid by billions', May 2019.
[13] Citizens Advice, Energy Consumers' Missing Billions, May 2017.
[14] Ofgem, RIIO-ED2 Impact Assessment, July 2020
[15] Ofgem, RIIO-ED2 Impact Assessment, July 2020

reinforcement, and on asset replacement and refurbishment. Whilst some of these savings are shared with consumers, and there are genuine efficiencies found, this also represents significant company profit. As a result, we think it is important that ED2 represents better value for consumers. Citizens Advice is pleased there are more mechanisms proposed to return unspent money to consumers.

We support Ofgem's efficiency drive for network companies and welcome the ongoing annual efficiency challenge for the DNOs proposed in ED2. While we await the exact details on the extent of the annual percentage challenge on totex allowances, we welcome the direction.

The ED2 price control does not detail many aspects of the financial arrangements for the DNOs at this stage, but if the RIIO-2 draft determinations are an indicator of what is planned, we feel that while the Ofgem has moved in the right direction on cost of capital, we think Ofgem can still go further. Our recommendations for the key cost of capital assumptions (Cost of Equity and Total Market Return) for RIIO-2 T & GD showed that they could save consumers at least £1.7 billion over the course of the RIIO-2 price control[16] if adopted. We feel that substantial savings are also likely for the ED2 price control if these recommendations are adopted for the DNOs' price control.

Separately to the Cost of Capital assumptions, an adjustment to the cost of equity for an expected outperformance of -1.60% rather than -0.25% would reduce allowed returns by up to £1.2 billion over the period of the RIIO-2 price control if adopted. ED2 could offer equally significant savings.

While many of the ED2 financial aspects are not consulted upon within the ED2 SSMC, it appears likely that many core elements will be the same as those proposed within the RIIO-2 draft determinations. With this in mind, we have set out below our views on cost of capital and other financial elements that will be relevant for the ED2 price control.

Ofgem is proposing to reduce the excessive profits evident in the previous price controls, but we think that there is more that Ofgem can do to reduce company

[16] See our response to the Annex 3 Finance section and our response to the RIIO-2 draft determinations, Citizens Advice response to RIIO-2 Draft Determinations for Transmission, Gas Distribution and Electricity System Operator, September 2020

returns at the expense of consumers. We still believe that Ofgem's calculation for company returns is generous and will reduce consumers' value for money. The RIIO-2 and ED2 price controls should be the mechanisms to stop overpayments to monopoly companies.

While Ofgem has moved in the right direction on cost of capital, we believe that the RIIO-2 draft determinations are still too generous and we have evidence that Ofgem could go further. **We give 8 reasons for why the cost of capital could be lower[17] in RIIO-2 and these points would be applicable if the same methodology is proposed for ED2:**

- **Equity beta** - On the basis of the longer-run raw betas estimated in the Wright and Robertson report – of 0.3-0.5 – Ofwat's asset betas would fall from 0.36 to 0.21-0.30, and notional equity betas from 0.71 to 0.33-0.55. Accordingly, Citizens Advice considers that Ofgem should apply an asset beta of at most 0.30, not 0.34-0.39, and a corresponding notional equity beta of at most 0.56, not 0.66-0.79. This alone would imply a reduction in Ofgem's allowed return on equity to at most 2.87%.
- **Total Market Returns (TMR): diversified portfolios** - On the basis that the TMR shouldn't just be based on the average returns on UK equities, but on the average returns on a wider and more diversified portfolio of investments, we would suggest that Ofgem's TMR of 6.25% to 6.75%, and Ofwat's TMR of 6.50% are too high, and should be closer to 4.0%.
- **Total Market Returns: actual market returns** - Ofgem should consider adjusting its use of historical market returns as a proxy for current forecast total market returns and take account of actual market forecasts which show that the market is expecting lower returns than Ofgem's analysis of historical returns. We find Ofgem's TMR assumption based on historical averages (6.25%-6.75% CPIH real) is higher than that actually expected by investors as shown by Ofgem's own data on forecasts from investment managers (4.8% CPIH real).
- **Cost of Equity** - We also assessed Ofgem's use of cross-checks for its cost of equity and found that its approach generates a higher cost of equity than is supported by the source data. The underlying data suggests a cost of equity of 3.1% compared to Ofgem's assumption of 4.2%.
- **Outperformance** - Our analysis of Ofgem's data suggests actual levels of expected outperformance by investors of 3.2% are revealed by market to asset ratios. On that basis we suggest a minimum adjustment of half of that amount, reflecting the fact that this is the first use of this

[17] See our response to the Annex 3 Finance section and our response to the RIIO-2 draft determinations, Citizens Advice response to RIIO-2 Draft Determinations for Transmission, Gas Distribution and Electricity System Operator, September 2020

improvement to the CAPM based methodology for setting a cost of equity. We propose an adjustment of 1.6%.
- **Ex Post adjustment** - We strongly disagree with Ofgem's proposed ex post adjustment. It is not necessary and is a one-sided measure for which consumers bear all the down-side risk with no upside.
- **Return Adjustment Mechanism (RAM): debt windfall** - We are concerned that companies may still generate windfall gains for shareholders as a result of debt outperformance. In our view it would therefore be reasonable to include debt costs in the RAM to provide an additional safeguard for consumers.
- **Return Adjustment Mechanism (RAM): lower beta** - We also consider that the RAM reduces the riskiness of the regulated companies for investors which should be reflected in a lower beta.

When proposing policy change, we think it will improve transparency and intelligibility if, where possible, Ofgem provides a cost comparison with a continuation of the existing policy.

Although we think the CMA should have gone further, it's interim findings for the PR19[18] appeal show that for the period 2019-2022 the cost of capital will be far lower than the generous rates that ED1 allows. DNOs will benefit from the difference, and we think Ofgem should take this into account (including where companies have returned money to consumers) when considering the shape of the ED2 framework and ultimately their determinations for companies.

Principle 2: The value of any unspent funding for infrastructure projects is returned to consumers promptly and in full.

We expect networks to deliver efficiently against planned investment with underspends returned to consumers, where the underspend is a windfall gain or due to non-delivery, and not based on any innovation or efficiency effort by the company.

Clawbacks of funding provided to companies where they have not delivered a project, or only partially delivered it, is another welcome move for many mechanisms proposed in ED2. The use of Price Control Deliverable expected outputs also brings more reassurance that companies must deliver what they are paid for.

[18] https://www.gov.uk/cma-cases/ofwat-price-determinations

Re-openers offer the opportunity to provide additional scrutiny as well as targeted funding for a project which helps to avoid the underspends that can arise when using baseline funding in totex allowances. The use of these mechanisms to address uncertain situations is welcome to ensure that underspends are minimised.

Net Zero reopener: It is vital that the RIIO-2 and ED2 price controls ensure that the network companies have the means to build and manage networks that can deliver Net Zero for consumers.

Ofgem approved some Net Zero-related infrastructure projects in baseline funding for the RIIO-2 companies totalling approximately £3 billion[19] for connecting renewable generation, for hydrogen research and development and trials, and for the ESO to help the system operate carbon free by 2025. An open-ended £10 billion amount of funding was reserved for uncertainty mechanisms via re-openers and the Strategic Investment Fund for areas including: EV rapid charging, connecting additional offshore renewables, and other Net Zero-related projects. The ED2 companies are also intended to access the Net Zero re-opener and the Strategic Investment Fund and will put forward their plans to facilitate Net Zero within their Business Plan submissions.

However, Ofgem did not require companies in RIIO-2 to provide a clear pathway to Net Zero, or modelled how to reach Net Zero, and **we recommend that Ofgem requires such a clear pathway to reach Net Zero for ED2**. We are supportive of the Strategic Innovation Fund in supporting Net Zero goals. We also welcome the newly formed Net Zero Advisory Group (NZAG) which we think is needed to help provide greater clarity on a Net Zero innovation approach and wider strategy, guidance on policy, technological changes, and legislative matters to Ofgem in the roll-out of projects funded by the Net Zero re-opener. At present, the NZAG appears to only be meeting at 6 monthly intervals and we believe that they may need to meet more frequently to respond to the scale of the challenge, the rapidly changing environment and the need for quick decisions on funding for Net Zero-related projects.

Totex incentive mechanism: The mechanism has been put in place to encourage efficient delivery by companies while sharing the benefits (as well as

[19] Ofgem, RIIO-2 Draft Determinations - Core Document, July 2020.

the costs of overspend) with customers.[20] We have seen that for the RIIO-2 network companies that there has been a move to reduce the share of underspend that these low risk companies can keep via the TIM, returning more money to consumers. We welcome the move to use the same Confidence Dependent Incentive Rate (CDIR) metric to recalculate the sharing factors for ED2 which should give fairer sharing of efficiency returns with consumers. The CDIR metric provides better assurance to consumers for more uncertain costs as less is kept via the sharing factor. Higher returns to companies are therefore more likely to be made where the company has made genuine efficiencies on these high confidence costs rather than on the basis of windfall gains. We also support penalties and clawbacks where funding is not used or used in a way that doesn't adequately mitigate future network risks for consumers.

Business Plan Incentive mechanism: The mechanism encourages companies to submit ambitious Business Plans which are then assessed through a 4-stage assessment process applying rewards and penalties to companies' costs as relevant.[21] We noted that the RIIO-2 T & GD network companies, particularly some transmission companies, failed to justify a large amount of proposed baseline funding to Ofgem. Optimally, we wanted to see well justified funding proposals, particularly related to Net Zero requirements, within baseline funding to ensure a rapid roll-out of projects. Such spending, detailed in the Business Plans, had been subject to considerable consumer input, stakeholder consultation, review by the respective Customer Engagement Groups or User Groups, and by the RIIO-2 Challenge Group. These Business Plans therefore had a high degree of public input and scrutiny. It is disappointing that the level of justification, costs information, and needs cases provided by the companies to Ofgem, as well as the engagement process with Ofgem, has not led to Business Plans sufficiently robust to allow for these projects in baseline funding. We want to see that the ED2 companies do not have the same issues and it is critical that there is effective communication by Ofgem of the requirements to justify ED2 plans as well as the companies ensuring that they provide the robust evidence that is needed.

[20] For further details on design of the mechanism and the calculation of the sharing factors, please see: Ofgem, RIIO-2 Draft Determinations - Core Document, page 118-122, July 2020.
[21] For example, the first step applies a fixed penalty of 0.5 per cent of totex to company business plans failing to meet the minimum requirements set for completeness and quality; while the second step rewards companies for offering additional value to consumers through the Consumer Value Proposition. For further details please see: Ofgem, RIIO-2 Draft Determinations - Core Document, page 122-138, July 2020.

Given the level of underspend in ED1 it seems some companies have had the option to invest more in network resilience and development for consumers during ED1 but chose not to. Underspend would also seem a likely contributing factor to the ED1 overspend on network faults and DNOs may need to address their underinvestment. We think Ofgem should be assessing past over-forecasting and under delivery against baselines when considering the funding mechanisms and required deliverables for funding requests in ED2.

Efficiency targets: Ofgem has proposed an efficiency challenge for the network companies in RIIO-2 to incentivise them as if they were companies in a competitive market. The efficiency targets will require innovation to ensure more efficient processes and lower cost projects. The efficiency targets were set at 1.2% for capex and repex and 1.4% for opex each year and we felt that these appeared suitably challenging and should drive lower cost and more efficient companies. Ofgem is intending to have similar annual efficiency challenges for ED2 although the exact percentage figures are still to be decided. We welcome this drive to embed operational efficiencies as Business as Usual and would look for similar percentage figures for the efficiency challenge for ED2 companies.

Return adjustment mechanism (RAM): This is a failsafe mechanism to mitigate the risk of companies earning returns that are materially different from what is expected. We think this will be improved by including debt earnings.[22]

Principle 3: Industry Business Plans and regulatory decisions are directly informed by consumer (including future consumer) feedback and research.

The enhanced engagement requirements that were introduced for the RIIO-2 price control companies have now also become stipulations within the ED2 price control. We have welcomed the development of this increased focus upon stakeholder engagement and the use of Customer Engagement Groups (CEGs) and the RIIO-2 Challenge Group to provide additional scrutiny of DNOs' business planning. However, we are disappointed that Ofgem has not included the ED2 enhanced engagement guidance in this consultation. We would have liked to have had the opportunity for stakeholders to provide input and comments about the guidelines developed in the enhanced engagement document. We would encourage Ofgem to consult with stakeholders on engagement specifically before finalising their decisions in the Sector Specific Methodology Decision.

[22] Ofgem, RIIO-2 Draft Determinations - Core Document, p.183, 2020.

Furthermore, we would like to see Ofgem provide guidance on what constitutes robust and high quality stakeholder engagement. We agree that it is the role of companies to decide the frequency of engagement and who they engage with but it would provide clarity to DNOs if Ofgem could provide further details and criteria of what they would expect to see in the enhanced engagement process. For example, Ofgem could provide examples of best practice of high quality stakeholder engagement, including examples of consumer engagement, which would be beneficial for clarity for DNOs. As a guide, we recommend reviewing Cadent CEG's framework for quality engagement[23].

The clearer Ofgem can make their expectations of DNOs in stakeholder engagement the easier it will be for DNOs to understand their requirements and ensure their Business Plans are well evidenced with stakeholder engagement throughout. This will aid in making it more transparent where companies have performed strongly or poorly in this area in the assessment of their Business Plans. We think it is important that DNOs have this further guidance as it is an area in which a lot of time and resource is spent by DNOs, some of which is funded by consumers, therefore efforts should be made to ensure these are spent in the best way to maximise value.

We are also disappointed not to see Ofgem mention lessons learnt from the RIIO-2 processes that have already been undertaken for enhanced engagement and from the work of the CEGs, user groups and challenge groups. Sustainability First also noted the importance of regulators being able to learn lessons and evaluate the impact of these groups[24]. They recommend the inclusion of non-quantifiable elements in which groups may have had impacts, for example changing the culture of companies. We believe there are lessons to be learnt that Ofgem could share to avoid the duplication of work and mistakes which have not resulted in outputs with high quality stakeholder engagement and evidence. It would also be beneficial to prevent the waste of resources by sharing these lessons. Ofgem should share learnings as soon as possible.

As mentioned in our response to Ofgem's draft determinations[25] we would like to see increased transparency in how Ofgem has weighted and used stakeholder evidence in its decisions. We think that the current lack of transparency in decision-making in the draft determinations could risk stakeholder commitment

[23] Cadent Gas, Cadent CEG Quality of Engagement Assessment Framework 2019.
[24] Sustainability First, Consumer involvement in billion-pound energy and water sector price controls - a think piece, 2020.
[25] Citizens Advice, Response to RIIO2 Draft Determinations, September 2020.

to ongoing enhanced engagement in RIIO-2, and Business Plan development in ED2. We would like to see Ofgem provide further details of its expectation of stakeholder engagement in ED2 and show its commitment to valuing this evidence in its decisions in ED2. We also expect to see this addressed in the final determinations for the gas and transmission sector.

We encourage Ofgem to explicitly consider how to respond to the uncertain implications of the COVID-19 pandemic for consumers and how these may affect the stakeholder engagement process for ED2. Both Ofgem and regulated companies need to consider the possible scenarios for the duration and economic impact of the pandemic and focus on the potential range of impacts.

In terms of the guidance provided for the CEGs, Ofgem could be clearer on the role of CEGs in financial issues. The guidance states that it expects CEGs to challenge the company on the proposed outputs and associated total expenditure ("totex") budgets, but also says it does not expect the CEGs to discuss or review specific financial topics[26]. We find this contradictory. Ofgem should be as clear as possible from the outset where they would particularly like to hear views from the CEGs on the Business Plans[27].

Ofgem also states they may provide further guidance for the CEGs on the structure and content of the reports to be written by the CEGs. Ofgem should ensure they inform the CEGs as early as possible what it is they expect to see in their final report to allow CEGs to collect the necessary information over a period of time to form their opinion. We think Ofgem could more broadly improve standards in the guidance provided for the CEGs.

Ofgem states that chairs may want to add additional CEG members throughout the process - it would be useful to hear if Ofgem have specific times in the process where they think this would be most appropriate. We agree with Ofgem that the membership should ensure that both consumers in vulnerable situations and future consumers are well represented. Ofgem states that they will take account of the level of support provided to each CEG, and their ability to act independently. It would be helpful to hear Ofgem's thoughts in more detail in how they will assess the ability of CEGs to act independently; for instance if Ofgem has criteria in mind for this and how Ofgem will reflect this assessment. We welcome the expectation that the CEG will provide a report, outlining the

[26] Ofgem, Enhanced engagement guidance, July 2020.
[27] Sustainability First, Consumer involvement in billion-pound energy and water sector price controls - a think piece, 2020.

arrangements to ensure independence. We feel it is of the utmost importance that CEGs are transparent in their relationship with their respective company and remain as independent as possible to perform their role effectively. Ofgem should ensure any further guidance for the CEGs is provided well in advance of any deadlines.

We recommend that Ofgem:

- Undertakes a thorough Ofgem-run **review of the enhanced engagement process to ascertain the effectiveness of the Customer Engagement Groups, User Groups, the RIIO-2 Challenge Group,** their respective Terms of Reference, whether there was duplication or omission, and to use the learnings in the ED2 price control process. We would also encourage Ofgem to assess and publish its views on how enhanced engagement has benefited the regulator's review of Business Plans, and whether more flexible regulation has been made possible through it.
- **Provides further guidance on what constitutes 'robust and quality engagement'** to raise the standard consistently across all companies for processes such as customer segmentation (including consumers with vulnerabilities, and future consumers), research methodology, willingness to pay, triangulation, trade-offs, linkages to Business Plan activities, and acceptability testing.
- Provides evidence of **how consumer evidence factors in the ED2 draft determinations,** particularly on bespoke proposals.
- Ofgem provides evidence of **how consumer and CEG input is considered by Ofgem** in the ED2 draft determinations.
- **To mitigate some of the concerns and limitations associated with stated preference approaches in willingness to pay research,** additional evidence provided by companies may be useful in **providing regulators confidence regarding consumers' values**. For example, where suitable revealed preference studies may be used to complement the results obtained through stated preference methods, thus increasing the robustness of estimated consumer valuations.[28]
- **To trial the Open Hearings process during RIIO-ED2.** It was not possible to see this process in action during RIIO-2 due to the COVID-19 pandemic and its value is yet to be ascertained.

[28] For example, a study commissioned by the Consumer Council for Water provides recommendations on maximising the complementarity of stated and relevant preference approaches. For further details, please see: Consumer Council for Water, Improving willingness-to-pay research in the water sector, 2017.

- **Use an ODI-F stakeholder engagement incentive in ED2** to incentivise companies to reach a consistent best practice level, reward exceptional engagement practices, and further embed stakeholder engagement within the company activities
- **Design the ODI-F stakeholder engagement incentive with the following features:**
    - Based on robust and high quality engagement as the minimum baseline standard
    - Modestly-sized and symmetrical (so that companies could receive either rewards or penalties for engagement that is above or below the minimum standard)
    - Judged on an ex post basis

Principle 4: Companies are required to publish complete information on their performance, financial structures, gearing and ownership.

In RIIO-2 T & GD, Ofgem, following Ofwat's example in PR19, has taken a number of measures to require greater openness from networks, and we would expect these same measures to be incorporated within ED2. For companies that will likely be trusted to deliver the tenets of GB's response to powering Net Zero, it is vital that they have a high level of accountability to consumers.

Consumer trust of network companies, and of the vital Net Zero policies that they deliver, will shape consumer support and willingness to pay. As a result, greater accountability to Ofgem over tax allowances, disclosure of executive pay and of dividends are very welcome. Networks will also be required to link executive pay to the performance of the regulated businesses, which should incentivise staff performance appropriately. When considering a company's Business Plans these factors are highly relevant because they provide examples of how a company creates a culture of efficiency when working at the expense of captive consumers.

The ED2 price control represents a critical period in the road to achieving Net Zero and with this comes significantly increased stakeholder interest and the need for greater public scrutiny. As a result, we welcome the new Annual Environmental Report (AER) which will enable network companies to report on progress against the commitments they have made in their Environmental Action Plans (EAPs).

We also think there is value in an annual environmental showcase event for ED2, similar to that proposed for vulnerability activities in the gas distribution sector. This would give companies an additional opportunity to present and invite scrutiny of their AERs, the progress they are making to decarbonise their business operations and their key role in the Net Zero transition.

Principle 5: Innovation funding and incentives support consumers in the transition to a low carbon future, particularly those consumers in vulnerable circumstances.

Innovation

Research into new technology, processes and procedures, and the implementation of these innovations into the energy network industry and the DSO functions are vital elements to ensure the success of the Net Zero transition. In non-commercial companies, it may be necessary to stimulate innovation via incentives or through making available funds for this purpose. We therefore welcome the support for innovation within the ED2 proposals, namely:

- Strategic Innovation Fund which is designed for large projects relating to wider strategic innovation
- Network Innovation Allowance which is for smaller projects focused on longer-term transition issues or consumer vulnerability
- Annual efficiency challenge which should drive operational innovation and implementation

It is vital that these innovations are inclusive and will benefit a diverse range of consumers, with particular attention to the fuel poor, recognising that these consumers already face significant barriers to accessing the benefits offered by low carbon technologies. Insight needs to be shared widely within the sector and beyond, and that the successful projects become part of the energy networks' Business as Usual (BAU) as rapidly as possible to gain the greatest consumer benefits and achieve Net Zero goals.

The DSO roles of the DNOs will require the development of new ways of working, data gathering and dissemination, and systems. **We would recommend that DNOs look to collaborate wherever possible to reduce costs to consumers** to avoid DNOs establishing duplicate solutions.

The **Strategic Innovation Fund (SIF)**, worth approximately £450 million (or more if needed), is a replacement for the Network Innovation Competition and has been extended from the RIIO-2 T and GD companies to include the DNOs. We welcome the SIF which is designed to fund higher value (above £5 million) Net Zero-related projects, and support projects that would be unlikely to be undertaken via BAU activities. The use of a sector-wide strategic innovation strategy to guide overall direction, largely led by BEIS, is also welcomed along with the intention for collaborative projects with BEIS, UKRI, third party innovators, and other bodies. The whole systems focus, cross-sector approach, and ability to respond to changes in government policy or technological initiatives are also welcome features of the SIF.

We note that there will be further work and consultation to develop detail regarding the SIF and acknowledge the identified list of issues for consideration including defining 'innovation'.

We would recommend that the following aspects be included in these considerations for the SIF:

- **A focus on distributional impacts and inclusion for consumers with vulnerabilities and low engagement with energy.** The description of the SIF does not provide any specific processes to address these issues and we would ask that all projects have these considerations included within them.
- **We believe that there should be a high bar for approval of projects,** as these innovation projects are being funded via the existing use of system charges methodologies and therefore socialised across GB consumers. **Affordability may be an increasing concern due to the likely economic impacts of COVID-19**[29] and the potential benefits must be clear and of significant value.
- There may be a need to **develop new robust cost and benefit analyses** to assess these projects including the social benefits that may accrue to consumers, including those consumers with vulnerabilities. **We recommend the inclusion of the SROI methodology,** when finalised, in these analyses.
- **We would welcome further information regarding how the percentage of funding that will be borne by consumers or companies is decided.** At present, Network Innovation Competition (NIC) funding is

[29] Citizens Advice, Meeting Net Zero - Options for network company highly anticipatory investments in a post-COVID-19 environment, July 2020.

shared 90% to consumers, 10% with company participants. The SIF fund percentages will be decided on a case-by-case basis according to the proposal within the RIIO-2 T and GD draft determinations and we would welcome information regarding how certain projects would attract different percentages of consumer support compared to others and the criteria used for these allocations. It would be useful to know, for instance, whether the likelihood of success, or extent of consumer benefit compared to the cost may be relevant factors in such a decision.

- **There was no specific mention of IDNOs or IGTs** and while these companies may be included as 'third party' partners, we would welcome stated consideration of these companies to ensure an inclusive approach to innovation funding.
- Assessment of the SIF funding and its outcomes may necessarily take some time to realise, however, **it is important to include an evaluation of individual projects and the scheme as a whole,** to assess its value and whether it has met its objectives.

The expectation of more innovation within BAU, as stated within the ED2 proposals, should drive operational efficiencies. **We recommend that a mechanism is put in place so that these innovations, also funded by consumers as much as the specific innovation funding pots, are communicated widely so that efficiencies can be implemented across the industry.**

We are supportive of the continuation of the **Network Innovation Allowance** (NIA) scheme and the consistent approach taken between the RIIO-2 T and GD companies and the DNOs as well as the proposed size of the funding for the networks.

This fund needs to enable continued innovative solutions which the market alone might not provide. We welcome the focus of the NIA fund on longer-term energy system transition challenges or consumer vulnerability issues. In particular, we support the new proposed new reporting framework and requirement of the impact assessment to consider the expected effects of the innovative solution upon consumers with vulnerabilities.

We have the following recommendations relating to the NIA:

- **We would recommend that at least one partner is required to be a participant within each NIA project to facilitate wider viewpoints and learning**
- **The reporting framework should highlight where projects have collaborated across the different energy sectors** and led to whole systems solutions, as well as detail the partnerships and why they were chosen
- **Potential partner consideration should include community groups, social housing groups, local authorities and academics**
- **The proposed reporting framework should include robust dissemination procedures** to ensure that the lessons learned are able to be used by other industry companies and sectors, and within the wider community
- **Ofgem should set out clear guidance on the boundaries between funding projects** relating to vulnerable customers via the NIA and the UIOLI allowance
- **That there should be a requirement for companies to explain why apparently successful innovations used by other companies have not been chosen to be used as BAU within their businesses**
- **Innovations that appear to be universally applicable and of value should be considered for mandatory roll-out across all DNOs**

Vulnerability

The DNOs have a significant part to play in people’s lives as electricity is an essential service with growing importance as people become more reliant on electricity for their working and home lives. However, some consumers are particularly vulnerable to supply interruptions for example due to a medical reliance on electricity, a disability or mental health issue, or through being in fuel poverty and having affordability issues with dealing with an interruption. Some consumers may have needs, such as language-accessibility and it is important for DNOs to provide the customer service that meets their needs. However, the consequences for an interruption for some people can be severe or even life-threatening. It is essential that the DNOs have appropriate proactive processes and practices to support all of their customers, but particularly those in the more vulnerable situations.

DNOs also have a key role to play through their unique touchpoints with consumers. The price control should provide clarity of what is expected of networks relative to other industry participants such as suppliers. This should include a drive for DNOs to maximise their use of touchpoints via information, advice and partnerships to deliver valuable and efficient services. These services should help to address circumstances which make their customers more vulnerable either to an interruption, to fuel poverty or to not being able to engage or benefit from the energy system transition in alignment with Ofgem's Consumer Vulnerability Strategy 2025[30], and the Vulnerability Principles and minimum standards set out in the SSMC.

We support Ofgem's approach to addressing consumer vulnerability through an overarching principles-based licence obligation and to introduce a framework in the form of a financial Output Delivery Incentive (ODI) to require companies to have a vulnerability strategy which includes minimum baseline standards. We support Ofgem's aims to drive ambitious proposals, deliver convergence across all DNOs and reward companies for outperformance of tangible consumer outcomes and penalise companies for non or under-delivery of activities within their strategies.

We broadly support the proposed Vulnerability Principles and associated standards as set out in Appendix 5 of Annex 1. It is important that all customers in GB can expect a similar minimum service level from DNOs. In response to OUTQ20 we set out where we think these could be more specific or more challenging. For example, there is little mention of fuel poverty in the principles and standards despite it putting consumers at greater risk of vulnerability during an interruption, constituting a barrier to fairness of service, and acts as a significant barrier to participating in a smart flexible energy system. We also consider that transient vulnerability could be better reflected in the standards to ensure vulnerability is not too narrowly defined. We also urge Ofgem to be more explicit in encouraging DNOs to have partnerships from multiple sectors including other utilities.

We also welcome the role of the CVP in driving new enhanced minimum standards. We hope this will drive innovative or ambitious activities and targets in Business Plans with which Ofgem can 'level up' other DNOs where this is appropriate.

We welcome the introduction of the ex post assessment as an incentive for companies to deliver or outperform their targets in supporting customers in vulnerable situations and to penalise companies for non or under-delivery of activities. However, we **recommend that this is conducted on an annual basis** to avoid shortcomings being identified too late and to give companies the

[30] Ofgem, Consumer Vulnerability Strategy 2025, October 2019

flexibility to adopt best practice and shift focus where it is appropriate or necessary to do so. We think Ofgem should find ways to incentivise longer term deliverables in their annual assessment, to encourage DNOs to deliver outputs over the period of the price control and be rewarded or penalised for progress of their delivery of outcomes annually. We welcome the new focus on ensuring the use of common metrics and ensuring performance is as comparable as possible. This should enable better and clearer scrutiny and enable a better ex post assessment process.

Ofgem rightly notes that customers in vulnerable situations could suffer detriment by, "*paying for some of the costs associated with the benefits they either are unlikely to be able to, or cannot, access*" through the energy system transition. We agree with Ofgem that during the course of ED2 and beyond, this is a significant detriment that could be faced by customers. We agree that DNOs wherever possible should aim to mitigate this impact during the energy system transition and be ambitious in the ways they do this, including through new innovative solutions funded through the Network Innovation Allowance (NIA). However, we also recognise that DNOs have no control over pricing, tariff structures, and government policy costs which will ultimately determine whether or not customers are paying for benefits they are unlikely to be able to, or cannot, access. In addition to efforts by DNOs to consider and mitigate the distributional impact of investments, **Ofgem should ensure that costs associated with decarbonisation are distributed fairly, for example though a mechanism of subsidisation.** This issue is covered in 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'[31].

We agree with Ofgem that "*a DNO's role should be to support vulnerable consumers where the DNO's competence and opportunity for consumer interaction puts them in the best-placed position to deliver that support*". However, as we stated in our draft determinations response[32] for the gas distribution sector, **we also think Ofgem should seek very early clarification, in light of the impacts of COVID-19 that we describe elsewhere on willingness to pay and affordability issues, on what it is appropriate for the price control to fund.** While we want the price control to enable DNOs to be flexible in thinking of new and innovative ways they can address vulnerability and fuel poverty, clarity on areas that are outside the scope of the price control would enable better focus

[31] Citizens Advice, 'A price control for everyone', December 2018,
[32] Citizens Advice, Response to RIIO-2 Draft Determinations - Sector and Company Specific Sections, September 2020

on those areas they can carry out. Ofgem should ensure an appropriate balance between DNOs maximising their roles and providing good value and ambitious services with the inherently regressive funding mechanism of services being paid via energy bills.

Our key recommendations are:

- **Ofgem should seek early clarification from BEIS** on what activities to support customers in vulnerable situations is appropriate for the price control to fund.
- **Ofgem should set a target, early in the price control, for common metrics to enable comparability of performance.**
- **Ofgem should be clear that it expects, as a minimum standard, high quality measurement of outcomes** through partnership working and a convergence of methods of measuring delivery and outcomes.
- **Ofgem should provide more guidance on the operation of the CVP** and how DNOs can provide ambitious plans which also allow delivery to be suited to local or regional needs.
- **Vulnerability minimum standards should be delivered from the first year of the price control** and in every subsequent year of the price control to ensure consistent delivery.
- **Fuel poverty should be reflected to a greater extent** in the Vulnerability Principles and minimum standards.
- **Ofgem should make clearer how it will clawback funds under the incentive regime where necessary.**
- **The ex post assessments should be conducted annually and Ofgem should find ways to incentivise longer term deliverables in their annual assessment,** to encourage DNOs to deliver outputs over the period of the price control. **Assessments and decision making should be transparent and be undertaken by an independent panel** with appropriate expert knowledge to assess the DNOs activities.
- **Ofgem should explore how the costs associated with the energy system transition can be distributed fairly** to prevent those who are unlikely to be able to, or cannot, access the benefits from paying for them.

Distribution System Operation (DSO) transition

The electricity distribution system needs to become smarter and incorporate new ways of working to ensure that the Net Zero transition is achievable through the most efficient operation and network structure. The incorporation of DSO functions is a necessary part of this development of the electricity system. In recognition of the importance of DSO within the larger energy transition and to the success of net zero, we have responded to many consultations and position papers on this subject in the recent past, including:

- Citizens Advice response to the BEIS Call for Evidence on Facilitating Energy Efficiency in the Electricity System, September 2019[33]
- Citizens Advice response to Ofgem Position paper on Distribution System Operation: our approach and regulatory priorities, October 2019[34]
- Citizens Advice response to Ofgem Open Letter Consultation on approach to setting the next electricity distribution price control (RIIO-ED2), October 2019[35]
- Citizens Advice response to the Ofgem Key enablers for DSO programme of work and the Long Term Development statement consultation, February 2020[36]

These papers have set out our key asks for the DSO transition including:

- Clear boundaries between DNO and DSO functions to enable cost transparency and review, and to facilitate independence of operational DSO decisions or eventual full separation of the DNO and DSO activities
- Consideration of how to incorporate energy efficiency within operational DSO decisions for alternatives to reinforcement, in addition to consideration of flexibility services
- Ensuring that consumer protections, distributional impacts, and consideration of those with vulnerabilities who may be left behind in the transition, are considered in DSO design and operation
- Comprehensive stakeholder engagement to ensure that all relevant views, including those of community groups and consumers, are taken into account in developing DSO functions
- Ensuring that the recommendations of the Energy Data Taskforce[37] are taken up so that data on network constraints and assets is available so that potential flexibility market participants can respond.
- Transparency and fairness in decision making relating to contracted flexibility services including in dispatch decisions.

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[33] Citizens Advice response to the BEIS Call for Evidence on Facilitating Energy Efficiency in the Electricity System, September 2019
[34] Citizens Advice response to Ofgem Position paper on Distribution System Operation: our approach and regulatory priorities, October 2019
[35] Citizens Advice response to Ofgem Open Letter Consultation on approach to setting the next electricity distribution price control (RIIO-ED2), October 2019
[36] Citizens Advice response to the Ofgem Key enablers for DSO programme of work and the Long Term Development statement consultation, February 2020
[37] Energy Systems Catapult, Energy Data Taskforce Report, June 2019

- DNOs to be required to facilitate the secondary markets in flexibility resources, including peer to peer trading, and to also act to encourage participation by less knowledgeable or smaller groups

We are largely supportive of Ofgem's proposals regarding the DSO transition but do have comments on specific proposals that are detailed within the responses to the DSO transition questions. We welcome, in particular:

- The new required DSO principles and roles
- The DSO Strategy to be submitted as part of the minimum requirements for the Business Plan Incentive
- The introduction of licence conditions addressing aspects of the DSO functions within ED1, including the new network development plan (NDP) licence condition concerning planning requirements derived from DNO Distribution Future Energy Scenarios (DFESs)
- The requirement within the Business Planning Guidance for DNOs to describe how they will manage any apparent or actual conflicts of interest with respect to their DSO functions

Our key recommendations on DSO are given below:

- **Costs and revenues for DSO functions are clearly separated from DNO activities.** This would aid in cost transparency between DNOs, assist in identifying DNO achievement of DSO efficiencies, and more readily enable future separability, if needed. **A DSO 'TIM' could be used for the separate DSO revenues to act as a DSO specific incentive mechanism.** The DSO TIM could have a different sharing factor from the DNO TIM to drive faster efficiencies in this relatively new activity for DNOs. Use of a separate TIM for DSO will require a close costs assessment of the DSO baseline values to ensure that they are accurate and reflect value for money and calibration to ensure that the sharing factor drives the correct behaviours.
- **Ofgem needs to put in the building blocks now to gather evidence for the assessment of any future formal or legal separation** for the DSO functions and **set a clear timeline for this assessment** so that companies and stakeholders know what is intended.
- **Positive ideas that are identified during the business planning process or during Business Plan submission, and which are of universal application, should become requirements for all DNOs** and funded within DSO baseline allowances.
- **Consider using the following points** when assessing rewards or penalties in any DSO specific incentive mechanism where there has been

activity which goes beyond the minimum requirements or fails to meet the minimum requirements:

  - **Using those ESO incentive reward and penalty measures that are applicable to DSO functions** to ensure consistency between the sectors and to take the best practice from the ESO assessment mechanism
  - The suitability of design and the implementation of DSO activities that aim to address **distributional impacts, inclusivity, and effects that may be detrimental to consumers with vulnerabilities**
  - Activities that aim to **encourage participation in flexibility markets including those targeted at community groups or consumers that may be less likely to participate due to lack of knowledge**
  - **Stakeholder satisfaction with DSO activities**. This could be a separate new survey requirement with information gathered from those tendering or contracting flexibility services or from other stakeholders that are active in the market or intend to be, or those using the forecasting or other constraint information services supplied by DNOs, for instance
  - **Efficiencies identified and shared with the sector**
- **Annual DSO incentive assessments**, which would include the use of an independent assessment panel staffed with personnel with appropriate knowledge of distribution level activities and the needs of the end users in the DNO licence areas
- To continue to **pursue the assessment of whether DNO and DSO activities should be separate** and which institutional governance arrangement may be best suited to protect against apparent or actual conflicts of interest and resultant consumer and stakeholder detriment. Stakeholder input should be regularly sought when considering this important issue.
- **Increased collaboration between DNOs to drive cost efficiencies**, which may be particularly relevant for the new systems and processes to deliver DSO functions.

Other issues

Impact of COVID-19

The COVID-19 pandemic struck the UK in spring 2020. We appreciate that the implications from COVID-19 are still uncertain but it's already clear that issues around consumer affordability will have become more acute.

One in 9 people, the equivalent of 6 million people nationwide, has fallen behind on a household bill because of coronavirus[38]. **We would ask that Ofgem considers its approach to baseline funding for ED2 to factor in the likely dampening in consumer willingness to pay due to COVID-19**. The scale of this impact should be reflected, not just in more efficient baseline funding, but across the whole price control proposal. COVID-19 is also having a wider energy system impact driven by more home working, depressed demand for energy on the system overall and new demand profiles[39]. The costs of responding to these changes is likely to impact consumers,[40] alongside higher unemployment and redundancies, increasing consumer debt, and general pressure on household incomes.

These issues could have potential implications for the operations of DNOs over the period of the price control. For example, they could potentially lead to less investment in some areas due to demand changes, reduced consumer willingness to pay for new projects, and potentially less ability or appetite for consumers to support extensive infrastructure expansion.

There are a number of uncertainty mechanisms, including re-opener mechanisms, that have been proposed within this consultation, however, **we would recommend that a specific COVID-19 re-opener mechanism** is considered to allow for adjustments to baseline or other revenues as better information is gathered on the implications for network operations.

Ofgem capacity

The RIIO-2 and ED2 price controls are being developed within a background of potential changes in the environment, technology, policy and social activity caused by changes in working and other practices. The uncertainties created by these changes have resulted in Ofgem proposing the use of many uncertainty mechanisms, particularly re-openers. While we welcome the added consumer

[38]Citizens Advice, Six million fall behind on bills because of coronavirus, August 2020.
[39] National Grid ESO, The actions we're taking to manage reduced demand for electricity this summer, May 2020.
[40]Balancing costs are up to £718 million over March to July, which is a 39% year on year increase Ofgem, Open letter our review high balancing costs during spring and summer 2020, 2020.

protection that these uncertainty mechanisms bring in terms of scrutiny on costs, timing and needs-cases for projects, these mechanisms also create an additional administrative burden on Ofgem. In order for these mechanisms to work efficiently and rapidly so that the network companies can fulfil their roles to facilitate Net Zero. There is a risk that with a busy agenda Ofgem will be stretched, **Ofgem will need to ensure it has sufficient capacity to deliver these mechanisms and the assessment of any applications, amongst competing corporate priorities.**

Overview Questions

Interlinkages and CMA Appeals in RIIO-2

OVQ1 Do you have any views on our proposal to include a statement of policy in Final Determinations that in appropriate circumstances, we will carry out a post appeals review and potentially revisit wider aspects of RIIO-2 in the event of a successful appeal to the CMA that had material knock on consequences for the price control settlement

Ofgem's proposals for ED2 appear to be designed with significant interlinkages to balance the various objectives of the price control. We support this proposal as it is important that any changes as a result of an appeal do not create knock on impacts that adversely impact consumers.

As Ofgem expects electricity networks to act as "responsible long-term guardians of critical infrastructure" we think this should guide their behaviour in appeals. We think this role can be demonstrated by giving due consideration to the potential consumer impacts of appeal to the CMA. We are keen to see consideration of costs and delays associated with the appeals process against the opportunity for changes to the price control. Also, when defining an appeal, there should be consideration of the breadth of interlinkages in the price control that need to be addressed to create poor outcomes for consumers. If these behaviours are shown in appeal it could reduce the role of Ofgem in determining how to revisit wider aspects of RIIO-2 and ED2.

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

As outlined in OVQ1, as electricity networks are seen to be "responsible long-term guardians of critical infrastructure" then this should extend to appeals. We encourage the timings of pre-action correspondence to be prompt with sufficient transparency to mitigate any risk of consumer detriment.

Net Zero and Innovation

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

We note the following features of the Net Zero re-opener:

- Cross-sectoral
- Widely-drawn to encompass a broad range of potential investment needs
- Able to be initiated solely by Ofgem
- A materiality threshold in line with the principles for re-openers
- Adjustments can be made to allowed revenue, existing output targets, existing reporting requirements, or introductions can be made for new output targets and reporting requirements

We support the common nature of this re-opener with the RIIO-2 framework as it offers simplicity and clarity of approach. We believe that the widely-drawn framework of the Net Zero re-opener is an advantage in helping to meet potential currently unknown or less certain requirements to meet Net Zero. In addition, the cross-sectoral nature of the re-opener allows funding to be allocated to which industry sector needs it at that time. We note the discussion regarding the ability of Ofgem to solely initiate the re-opener and how some network companies wished to be able to trigger the re-opener. We appreciate the mitigations for network concerns that have been proposed such as consideration by Ofgem of matters raised through the Net Zero Advisory Group (which includes membership of the National Infrastructure Commission and the Committee on Climate Change), and the consultation process that will accompany any changes in circumstances when considering potential activation of the re-opener.

We believe that these mitigations strike an appropriate balance to ensure that the re-opener is only triggered for material changes, and that network companies and other stakeholders can input their views. We support the ability to amend or introduce output targets, and reporting requirements. We further support the use of a materiality threshold in line with the principles for re-openers proposed for RIIO-2 to offer consistency and to ensure that the costs of the re-opener process (for Ofgem and network companies) are only incurred (and paid for by consumers) when there is a substantial investment required.

It’s important that consumers and consumer advocates can understand the likely impacts of funds allocated through re-openers. **We recommend that Ofgem produces high, medium and low scenarios for the additional cost allowances that may result from re-openers along with the impact on customer bills and for meeting Net Zero to understand the impacts on bills that may result from use of uncertainty mechanisms.**

The fairness of the energy transition is a key issue for consumers looking to the future. **We recommend that the projects funded under the Net Zero re-opener routinely considers any distributional impacts relating to the project to ensure that certain consumers**, e.g. those with vulnerabilities, are not left behind in the transition or negatively impacted.

We also believe that it may be necessary for the NZAG to meet as it is required, rather than on a schedule, so that the Net Zero re-opener can respond rapidly to environmental, social, technological, or policy changes.

Strategic Investment for Net Zero

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

The National Infrastructure Commission (NIC) report ‘Strategic investment and public confidence’[41] 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 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 which major strategic investments would be appropriate to be outside 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.

[41] NIC, Strategic Investment and Public Confidence, October 2019

However, the UK government and devolved governments will need to consider the appropriate investment approaches for Net Zero because they hold the overarching responsibilities and funding strategy to meet their Net Zero objectives. We see the A-D models outlined by Ofgem for strategic investment in electricity networks as coping strategies that are applicable depending on the level of guidance received to address uncertainty about competing targets and delivery strategies for Net Zero.

Ultimately, the extent that networks, alongside other methods of delivery, are used to deliver Net Zero targets is a policy for the UK government, while the devolved governments have also set different targets, as have local authorities. Networks will now need to know how the various targets should impact their investment decisions. Providing clarity on the extent of network responsibilities is vital for policymakers and stakeholders to ascertain what other energy efficiency measures, consumer protections and support are required from government and other service providers.

Funding of the networks' role in Net Zero and their strategic investment should factor in their ability to offer fairness, both relative to the average bill contribution, but also distributional impacts and ability to help avoid consumer detriment.

One of the biggest challenges facing Ofgem and the DNOs in ED2 is how to build a framework to ensure that the electricity system of the future meets the changing needs of consumers in an effective, fair and cost-efficient way.

The distribution system will have to respond to the evolving demands on the system as consumers switch to more electricity-using products such as EVs and heat pumps. However, the situation is complicated with uncertainties relating to the timing and types of technological change, the availability of services to reduce peak and overall demand, national and local policy initiatives, consumer responsiveness, different regional targets for Net Zero, and economic factors.

The totex methodology used in the past has allowed DNOs to plan their networks and drive efficiency for more certain investments while re-opener mechanisms or volume drivers have been used to address uncertainties in timing or extent of demand until better information is available. The change required to deliver Net Zero, however, requires Ofgem and the industry to weigh a number of consumer benefits and risks for long-term investment. This means taking more informed risks in facilitating the electricity distribution system based on forecasting tools. It is therefore essential that the forecasting is as robust as possible and that the correct mechanisms are in place to incentivise, fund and monitor the delivery of strategic investments. Failure in these processes will lead to either the failure to make necessary investments or the risk of over-investment or investment too early.

We encourage Ofgem to work on a central forecast for strategic investment that should be a baseline from which companies have to justify why their forecast deviates. How networks can deviate from a central forecast needs to follow a highly standardised process to ensure transparency and fairness in the rationale and output of regional variation. This deviation should be incentivised to assess the long term implications of network interventions on costs and consumer benefit realisation.

Forecasting

The forecasting risks for ED2 have sizeable implications for consumers, DNOs, and government aims to meet Net Zero goals. If DNOs forecast demand as being too high, and invest in infrastructure on that basis, consumers may end up paying for underutilised 'stranded' assets for many decades, with DNOs over-rewarded through adding to their Regulatory Asset Value (RAV). On the other hand, if DNOs forecast too low a demand, and demand exceeds forecasts, then consumers will not be able to connect their Low Carbon Technologies (such as EVs or heat pumps) and Net Zero may be jeopardised.

It is therefore critical that forecasting is as accurate as possible while both protecting consumers from stranded assets and from the risk of constraints.

At present, there are centralised forecasts via the National Grid Electricity System Operator (ESO) Future Energy Scenarios process as well as a common scenario process via the Electricity Networks Association. Individual DNOs have also established their own Distribution Future Energy Scenarios (DFESs), however, there is a lack of consistent methodology with respect to determining the constituents or their weighting within DFESs. Some DNOs appear to use devolved government, Local Area Energy Plans (LAEPs) and other local authority aspirational goals for net zero within their DFESs to a great extent. Other DNOs may take a more cautious approach with regional inputs and rely on more certain data such as approved planning applications to add to their forecasts and use national forecasts for less certain net zero planning. This variability in approach by DNOs is compounded by the inconsistent approaches that can be taken to produce a LAEP as noted in the Centre for Sustainable Energy and Energy Systems Catapult report 'Local Area Energy Planning: The Method'[42] which could further compound the differences in forecasting produced by the DNOs. The Guidance, commissioned by Ofgem, has only been published on 30 July 2020, and therefore, it is unlikely that there will be fully consistent and robust LAEPs for DNO business planning purposes in time for ED2 submission. We are aware that there is also an ongoing project coordinated by the ENA to establish a consistent methodology for DFES production that reconciles better with the NG FES, however, it is not clear that the project's outputs, and any resultant changes to companies' DFESs can be incorporated in time for ED2 business planning completion.

We are concerned that there won't be a robust framework for developing and accessing standardised DNO forecasting by the introduction of ED2.

The slow progress so far is compounded by a risk in DNOs forecasting for their own systems where the network company is rewarded over the long-term for putting investments into the RAV. This risk of network companies forecasting the development of the system that a network builds also applied at the electricity transmission level and has been addressed by the separation of the system planning and forecasting function from the body managing the network. This is the case Dieter Helm makes compellingly in his Cost of Energy Review[43].

The National Grid ESO undertakes forecasting and assists in assessing network options for investment solutions, while the network investments are delivered by separate electricity transmission companies. We believe that there would be higher confidence in the distributional level forecasting if there was highly standardised forecasting and, ideally, system forecasting was separate from those that could potentially benefit from network investment decisions.

Having a clear and consistent methodology for producing DNO forecasts with well designed incentives could limit this conflict risk to some degree. It will likely require a significant shift in the way incentives and the RAV is constructed to prioritise system outcomes that offer value to consumers. However, we believe that a separation of forecasting for distribution level electricity demand is likely to be necessary to provide the necessary confidence in electricity distribution system forecasts. **We therefore recommend that Ofgem considers how it**

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[42] Centre for Sustainable Energy and Energy Systems Catapult, July 2020,
[43] Dieter Helm, Cost of Energy Review, 2017

will evaluate the consumer value of separating DSO functions, including forecasting, from the DNO. We recommend that Ofgem plans how and when it will gather evidence to progress this assessment. We also recommend that a clear timeline for assessment is given to provide a roadmap for DNOs and other stakeholders.

We are also aware that there is inconsistency with respect to understanding of capacity, usage, and constraints by DNOs for their Low Voltage (LV) networks. This lack of data is being addressed by DNOs through better monitoring of the LV network and use of other data (e.g. smart meter data). In ED2, the use of multiple data sources to model and anticipate network implications is an opportunity for innovation to minimise consumer costs. We support the incentivisation for DNOs to produce quality forecasts via the DSO Incentive mechanism which should consider the innovation used to produce forecasts. We would, however, **recommend that the ex post assessment of the DSO functions is undertaken on an annual basis.** See also our responses to OVQ20-21 for additional recommendations relating to the DSO Incentive mechanism and its assessment.

The long-term implications from the COVID-19 pandemic are still to emerge, but likely consequences could be changes to electricity demand profiles nationally and regionally, accelerating or decelerating timelines for green recovery or Net Zero policy initiatives, and the possible reduced ability or willingness of consumers to respond to those initiatives. As such, the forecasts at centralised levels or within the DFESs are unlikely to provide the most up-to-date and accurate bases for making investment decisions.

In summary, given the variability in local input, the different approaches to using the data for forecasting by DNOs, as well as the unknown implications from the COVID-19 pandemic, **there needs to be a cautious approach and a high standard set for using local forecasts for strategic investment price control planning purposes for ED2**. There needs to be a higher level of consistency in assessing local authority energy planning, and a consistent, robust methodology used by DNOs to incorporate LAEPs, local authority goals, and devolved government targets in their forecasting.

Mechanisms to deliver strategic investment

Ofgem has outlined a range of uncertainty mechanisms and strategies to try to provide strategic investment in ED2. The essence of the Ofgem strategy is to provide baseline funding at the start of ED2 where there is a clear and high confidence of investment requirement and to use other mechanisms to address currently less certain situations.

Using baseline funding within the totex mechanism

The underpinnings of the RIIO mechanism aim to provide companies with the flexibility to plan for their networks and implement those plans given that they are in the best position to know what is needed and how to deliver those plans. The totex mechanism gives flexibility across both capex and opex to choose the best solutions and the TIM adds an incentive through the sharing factor to drive efficient operational and investment decisions. The flexibility and relative simplicity of the totex mechanism, with appropriate design to fairly weigh the value of network interventions and regulator oversight of service delivery, has substantial advantages compared to more administratively cumbersome, time-consuming, and potentially delaying, uncertainty mechanisms. As such, **we would recommend that funding of strategic investment should be undertaken using the totex mechanism provided that the forecasting and justifications are highly robust**. We have noted above our concerns regarding the current accuracy of the forecasts for both national or centralised forecasting and DFESs and also the inconsistent methodologies used to determine DFES forecasting. **We would therefore recommend that caution is exercised by Ofgem to ensure that funding through baseline allowances uses forecasts, whether from centralised or decentralised sources, that reflect a networks competing licence priorities and up to date and accurate forecasts.** We therefore believe that it may be a valuable exercise for an expert team, including the National Grid ESO forecasters, to determine where forecasts deviate from central forecasts that they are robust enough to be used to add to baseline allowances.

We note the additional difficulty of aligning DFES localised regional forecasting with the boundaries of local and regional government structures and the implications for potential cross-subsidy by consumers in one locality for the benefit of consumers in another. **Determining the implications of cross-border subsidisation issues may also require a more sophisticated (and necessarily complex) way of allocating revenues between DNOs and we recommend further consideration is given to how this might be achieved.**

We expect that DNOs will critically evaluate regional or local inputs to their forecasts, however, **we recommend that Ofgem's scrutiny of DFESs, and other evidence provided by companies to justify accelerated regional or local strategic investment to meet Net Zero, should include the following considerations:**

- **The strength of the democratic mandate for the regional difference** (e.g. evidenced via electoral support for the local authority or devolved government plans)
- **Whether the aims of the devolved government, LAEP or other body are legally binding** upon that government or authority.
- **Whether there is a clear and realistic roadmap** to achieve the stated goals towards net zero rather than aspirations, for example:
  - Whether there are powers to facilitate implementation of the roadmap including whether there is any financial input that can be used by the authority or body to achieve its aims, or the ability, through law or other means, to ensure consumers, businesses or relevant partners will have to make changes to achieve the roadmap
  - The extent of that body's ability to implement the roadmap given that some parameters may be beyond their control such as national government policy, consumer willingness or ability to implement changes, or economic factors (e.g. due to COVID-19)

We would also recommend that Ofgem provides transparent reasoning once such decisions on regional differences for strategic investment have been made following submission of Business Plans so that it is clear why Ofgem has reached its decision and the weightings of the different criteria used.

Uncertainty mechanisms

Where there is significant uncertainty in the timing, extent, locality, or scope of demand for network services, Ofgem is intending to use uncertainty mechanisms (UMs) to manage the risks.

We commissioned research pieces[44] recently into how best to design mechanisms for highly anticipatory investments in energy networks. The research, conducted by Europe Economics, considers implications from the COVID-19 pandemic. The likely post-COVID-19 economic impacts mean that:

[44] Citizens Advice, Meeting net zero - Options for network company highly anticipatory investments in a post-COVID-19 environment, August 2020

- Reductions in the demand for energy may weaken the case for highly anticipatory investments
- Customer willingness to pay for improvements to the quality of service or the environment may be lower
- Affordability issues may be especially important given that many more households are struggling financially
- The case for applying real options analysis is especially strong in the current context with the value of the real option to wait now likely to be higher
- Cost and benefit analysis to value highly anticipatory investments will need to accommodate different COVID-19 scenarios and the ranges for estimated impacts are likely to be wider

While an economic recession has clear crisis and recovery phases, it may well be that post-COVID-19 environment will be linked to more fundamental changes to social and business behaviours. The actions of national and regional governments driving a green recovery may also result in an environment unlike those from prior recoveries and this may mean the electricity distribution network operations and structures may need to be different going forward.

The research we conducted pointed to the higher suitability of certain UMs in the current situation such as:

- Re-openers, particularly given the uncertainty caused by COVID-19 and the increased value of waiting for better information before committing to an irreversible investment
- Error correction mechanisms as a way to allocate more risk to network companies
- Economic depreciation mechanisms where depreciation payments from customers are profiled over time according to the time profile of asset use

Ofgem has proposed a number of possible UMs to meet uncertainties for strategic investment. However, we felt that there was insufficient detail to fully understand the incentives, their weightings, and possible outcomes of these mechanisms. We have outlined a number of points regarding the UMs below.

The opportunity for networks to identify and switch to more efficient solutions may be impeded when specific areas of spending are confined within a rigid deliverable or narrowly defined UM. This runs counter to the intention behind the RIIO totex regime to provide flexibility in how to deliver consumer outcomes.

We could not readily ascertain the interaction between the UMs, incentive mechanisms, and the TIM. For instance, the consultation does not specify whether any additional allowance granted under the capacity volume driver would be added to the RAV, and if so how and when. How this is done will have implications for what return the company is able to earn on the investment as well as for the costs borne by consumers. It will also determine the equivalence in incentive return of different network interventions.

We perceive a risk that companies may use their information advantage to gain from using the complex composition of different UMs and their incentives given their complexity and the difficulties for regulators in ascertaining efficient costs.

Volume drivers. These may encourage companies to invest beyond their consumers' needs. This risk could be exacerbated if the unit rate is set too high, given the informational advantage for DNOs. In addition, the context for an error correction mechanism, such as a volume driver, "*needs to be determined in relation to an objective and measurable variable that is outside the control of the company*"[45]. The proposed capacity driver does not fulfil this condition as the DNOs get to choose the capacity volume without a robust and highly standardised process. The DNOs have a high degree of discretion over the variable that the mechanism is linked to (i.e. it is endogenous rather than being exogenous and outside company control.)

To mitigate some of these risks, the volume drivers have associated incentives such as the Network Utilisation Strategy Incentive. However, we believe that the DNOs are unlikely to take on additional risks through the incentive mechanisms even for potentially higher rewards. These investments are expected to have lower utilisation in earlier years and the high risk of companies being penalised for such under-utilisation may deter investment. In addition, there are potential implications for the cost of capital when passing demand risk to the companies which need to be considered in the round for the ED2 price control. The combination of a potentially complex UM with an associated complicated incentive mechanism is not to be welcomed. The risks of incorrectly setting unit costs, and not calibrating the incentives for the right behaviours are heightened

[45] Europe Economics, Risk Allocation Mechanisms for Highly Anticipatory Infrastructure Investments in the Energy Sector, March 2020, page 30

with the increase in complexity. **Given these risks and the lack of an exogenous or robustly determined variable in the volume driver, we would therefore recommend that the proposed volume driver mechanisms and incentives be simplified and improved. Investment uncertainty could be addressed based on network estimated present value of future benefits relative to an intervention's costs. Networks could then be incentivised by risk and reward relative to evidence of overall consumer benefit realisation. This would appear to have less risk of failing to align incentives to achieve optimal forms of strategic investment for consumers.**

With respect to the other mechanisms proposed:

PCD with funding triggers linked to plans. This UM focuses upon the use of regional plans to facilitate the investment where there is an uncertainty relating to timing, but the type of output to be delivered is more certain. For instance, the penetration of EVs in congested areas that would require an increase in capacity could trigger an investment decision. Allowances would be automatically adjusted to reflect additional revenues upon submissions relating to the triggers. As currently set out it is possible that the PCD model will work effectively if timing is the main uncertainty. Any CBAs that aim to use PCDs must situate the output required in the broader context of how network intervention deliverables meet their licence conditions, for example factoring in consumer vulnerability factors and considering demand flexibility alongside reinforcement solutions. However, we point to our prior comments regarding the current issues surrounding DFESs and regional plans. Clawbacks should be used to recover funding where there is partial or non-delivery of PCDs.

Re-openers. We note the valuable role that re-openers can play where there are uncertainties with timing, scope, or location for investment, or where there are substantive changes in regional or national government policies. A re-opener may be necessary and has the advantage of detailed scrutiny and review that an automatic volume driver may not offer. If the volume driver is poorly calibrated or designed, there may be over or under funding, which may be avoided through a broader scrutiny offered through the re-opener system where a wider range of evidence could be provided to justify investment.

If networks are not able to provide robust regional forecasts by the introduction of ED2, an ongoing regional re-opener could be a means to accommodate the needs of regionally specific needs for investment which go beyond the centralised forecasts process as described. DNOs could apply to a regional re-opener as the regional demand forecasts gain clarity as to timing, locations for increased demand, the provision of distributed generation or flex provision, and when there is more certainty regarding the exact mix for the uptake of LCTs. The Net Zero re-opener offers a further avenue to gain investment funding where there are material changes to policy or due to governmental initiatives, such as schemes to encourage uptake of LCTs. We note the support to be provided by the Net Zero Advisory Group for the Net Zero re-opener and how the NZAG should provide additional assurance in the decision-making process, particularly with respect to technological developments, pace of change, regionality, and policy initiatives.

Any re-openers should be agile and responsive so that investment can be made as soon as possible as the need becomes evident. There will still be a continuing requirement for adequate justification to be made by DNOs including the use of CBAs to include flex provision as an option, evidence of capacity constraints, and locational demand.

Whichever UMs are selected for inclusion in ED2, **we would recommend that the design is such that they are responsive to the potentially rapid changes that may result from policy change or economic developments.** Similarly, **we would recommend that Ofgem ensures that it resources the teams working on the UMs so that they are able to make efficient and fast decisions. It may be valuable to have a dedicated independent panel to assist in making decisions** relating to projects under the various UMs, including the Net Zero re-opener in a similar fashion to the Networks Options Assessment (NOA)[46] process.

There is a risk of fluctuating bill profiles due to the use of the UMs and the distributional impacts may need to be ascertained further. **We recommend that Ofgem models the likely impacts to bill profiles and customer groups from the use of the UMs.**

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

See our response to OVQ4.

[46] National Grid ESO Networks Options Assessment process webpage

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

See our response to OVQ4.

OVQ7 What would be the factors that we should take into account that would give us high certainty in forecasted outputs derived through a decentralised approach?

See our response to OVQ4.

OVQ8 Do you consider that the LAEP Best Practice guidance produced by the Centre for Sustainable Energy and the Energy Systems Catapult provides adequate checks and balances to ensure that local or regional energy plans are robust, unbiased and have broad support?

We welcome the commissioning by Ofgem of research into LAEP practice and the issuance of the LAEP Best Practice Guidance by CSE and ESC. The Guidance will bring more consistency to the LAEP process, ensure comprehensive stakeholder engagement, evidence meaningful and reasoned commitments to implement it, as well as robust evidence-based methodology. Even with the Guidance, however, we are aware that local authorities will have differing resources to put to the development of their LAEPs or the Scottish Local Heat and Energy Efficiency Strategies[47], and may progress to follow the Guidance at different speeds. As such, there may be ongoing potential concerns regarding the confidence that can be placed on each local and regional plan as to how robust or thorough are these plans. There will need to be continuing scrutiny by DNOs and Ofgem as to the extent to which the local or regional plans can be incorporated within the forecasting process for investment planning by DNOs with incorporation dependent upon the robustness of the local or regional plan compared to the Best Practice Guidance.

There needs to be an explicit requirement for community and consumers' views to be taken into account and the need to undertake a mapping exercise to be inclusive in the LAEP Best Practice Guidance. We note the range of stakeholders at page 45 of the Guidance and the reference on page 47 to 'wider engagement' with the public. However, there is no reference to public engagement as part of the 'done well' checklist. **We would welcome a greater emphasis on the views of the citizens of the region or area rather than the higher reliance on community or consumer representatives. It will be important to understand the distributional impacts or trade-offs between different**

[47] Scottish Government, Energy Efficient Scotland,

groups of the LAEPs, as well as ensure that local citizens 'buy-in' to any proposals. Local buy-in should be a crucial part of the process and the public must be considered as key stakeholders if LAEPs are to succeed.

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

See our response to OVQ4.

Innovation

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

We support the proposals to expect companies to undertake more innovation as part of their BAU activities. Innovations relating to operational and maintenance activities should be part of a company's normal operations and we believe that the Totex Incentive Mechanism (TIM) should provide the necessary incentive to companies to drive such innovation. We would welcome a mechanism to disseminate information about these consumer-funded innovations so that other DNOs and their consumers could also benefit from the innovations. There is a risk that 'in-house' innovations may not be shared across the industry without a formal requirement to do so.

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

The Strategic Innovation Fund (SIF), worth approximately £450 million (or more if needed), is a replacement for the Network Innovation Competition, and was introduced within the draft determinations consultation for use by the companies covered in that consultation (gas and electricity transmission, gas distribution and ESO). We welcome the extension of the SIF for use by the DNOs. The SIF is designed to fund higher value (above £5 million) Net Zero-related projects, and support projects that would be unlikely to be undertaken via BAU activities. The use of a sector-wide strategic innovation strategy to guide overall direction, largely led by BEIS, is also welcomed along with the intention for collaborative projects with BEIS, UKRI, third party innovators, and other bodies. The whole systems focus, cross-sector approach, and ability to respond to changes in government policy or technological initiatives are also welcome features of the SIF.

We note that there will be further work and consultation to develop detail regarding the SIF and acknowledge the list of issues for consideration including defining 'innovation'. **We would recommend that the following aspects be included in these considerations for the SIF which mirrors the recommendations we made within our response to the draft determinations consultation[48]:**

- **A focus on distributional impacts and inclusion for consumers with vulnerabilities and low engagement with energy.** The description of the SIF does not provide any specific processes to address these issues and we would ask that all projects have these considerations.
- **We believe that there should be a high bar for approval of projects, as these innovation projects are being funded via the existing use of system charges methodologies and therefore socialised across GB consumers.** Affordability may be an increasing concern due to the likely economic impacts of COVID-19[49] and the potential benefits must be clear and of significant value.
- There may be a need to develop new robust cost and benefit analyses to assess these projects including the social benefits that may accrue to consumers, including those consumers with vulnerabilities. **We recommend the inclusion of the SROI methodology, when finalised, in these analyses.** The CBAs may need to accommodate implications from the COVID-19 pandemic.
- **We would welcome further information regarding how the percentage of funding that will be borne by consumers or companies is decided.** At present, Network Innovation Competition (NIC) funding is shared 90% to consumers, 10% with company participants. The SIF fund percentages will be decided on a case-by-case basis according to this proposal and we would welcome information regarding how certain projects would attract different percentages of consumer support compared to others and the criteria used for these allocations. It would be useful to know, for instance, whether the likelihood of success, or extent of consumer benefit compared to the cost may be relevant factors in such a decision.
- There was no specific mention of IDNOs or IGTs and while these companies may be included as 'third party' partners, **we would welcome**

[48] Citizens Advice, Response to RIIO-2 Draft Determinations for Transmission, Gas Distribution and Electricity System Operator, 2020
[49] Citizens Advice, Meeting Net Zero - Options for network company highly anticipatory investments in a post-COVID-19 environment, July 2020.

stated consideration of these companies to ensure an inclusive approach to innovation funding.

- Assessment of the SIF funding and its outcomes may necessarily take some time to realise, however, **it is important to include an evaluation of individual projects and the scheme as a whole, to assess its value and whether it has met its objectives.**

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

We support the consistent NIA framework for DNOs, other network companies and the ESO. We believe that a consistent framework will offer the benefits of simplicity and clarity, and facilitate greater involvement of cross-industry and third party participants as well as whole systems approaches.

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

We support the aims of the common reporting framework as we noted in our response to the draft determinations consultation[50]. We stated that we supported the framework which should track innovation activities through their lifecycle, enable coordination of activities and avoid duplication, improve dissemination of lessons learned, and facilitate evaluation of project costs and benefits for consumers.

Ofgem noted in the draft determinations consultation for the gas and electricity transmission, gas distribution, and ESO industries that those companies' applications for NIA innovation funding were largely independent of each other. This was the case even though Ofgem had encouraged companies to demonstrate collaboration across the different energy sectors. **We believe that the NIA reporting framework for all companies, including DNOs, should highlight where projects have collaborated across sectors and led to whole systems solutions**, or if the project did not, why collaboration and/or whole systems was not part of the design of the project.

Similarly, there should be a requirement for projects to explain the nature of the partnerships that were established and why certain partners were involved and why other potential partners were not included. If no partners were part of the

[50] Citizens Advice, Response to RIIO-2 Draft Determinations for Transmission, Gas Distribution and Electricity System Operator, 2020

project, companies should explain why and why the projects (and consumer benefits) are not negatively impacted by having only a restricted or solely industry-based partnership. The collaboration of community energy groups, social housing groups, local authorities, and academics should be included within the consideration of potential partners as well as better known consultancies and commercial companies. **We would recommend that at least one partner is required to be a participant within each NIA project to facilitate wider viewpoints and learning.**

We recommend that the proposed framework should include robust dissemination procedures to ensure that the lessons learned are able to be used by other industry companies and sectors, and within the wider community.

The reporting framework should highlight where projects have collaborated across the different energy sectors and led to whole systems solutions, as well as detail the partnerships and why they were chosen.

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

We are supportive of the continuation of the Network Innovation Allowance (NIA) scheme and many of its design parameters including the proposed size of the funding for most networks.

This fund needs to enable continued innovative solutions which the market alone might not provide. We welcome the focus of the NIA fund on longer-term energy system transition challenges or consumer vulnerability issues. In particular, we support the new proposed new reporting framework and requirement of the impact assessment to consider the expected effects of the innovative solution upon consumers with vulnerabilities.

We have the following recommendations relating to the NIA:

- **The NIA reporting framework should require all companies to collaborate with partners, as set out for the ESO. This should support stakeholder expert engagement and encourage cross-sector and whole system considerations.**
- **The reporting framework should highlight where projects have collaborated across the different energy sectors and led to whole**

systems solutions, as well as detail the partnerships and why they were chosen.

- **Potential partner consideration should include community groups, social housing groups, local authorities and academics.**
- **The proposed reporting framework should include robust dissemination procedures to ensure that the lessons learned are able to be used by other industry companies and sectors, and within the wider community.**
- **Ofgem should set out clear guidance on the boundaries between funding projects relating to vulnerable customers via the NIA and the UIOLI allowance.**

We note that Business Plan Guidance 4.31 states a requirement for Business Plans to explain "how plans for RIIO-ED2 build on past projects completed by itself and others, considering lessons learned from these past projects" when considering innovation. **We would recommend that this is expanded to have a requirement for companies to explain why apparently successful innovations used by other companies have not been chosen to be used as BAU within their businesses.** For instance, we would welcome understanding why certain DNOs have adopted voltage control measures, which appear to offer a low cost means to manage peak demand[51] as well as offering lower bills for consumers, while other DNOs do not appear to have adopted these measures. **Innovations that appear to be universally applicable and of value should be considered for mandatory roll-out across all DNOs.**

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

We agree with the proposed approach for setting individual levels of NIA funding for the DNOs where it is set at approximately the same level as in ED1 unless there is a strong case put forward within the Business Plan. As innovation for operational and efficiency measures should be within BAU for ED2, this would leave a greater level of absolute funding in ED2 to be used for innovations relating to the energy system transition, whole systems, or vulnerability-related projects.

[51] Electricity North West, Smart Street webpage

Modernising Energy Data

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

We agree with the approach proposed for regulating the harmonisation of networks' approaches to digitalisation so as to maximise the sharing of innovation and data to reduce costs to the consumer. This is even more pressing than in RIIO-2 given the opportunity for improved quality of data in electricity distribution to support focused consumer outcomes, for example in addressing fuel poverty or supporting demand response behaviours from consumers.

We welcome the consistent approach with the RIIO-2 network companies, as well as the Licence Obligations requiring regular publication of updates and improvements to the Digitalisation Strategy and Action Plan, and requiring use of data to meet the Data Best Practice guidance expectations.

We note that the DNOs will have had longer to work upon their Digitalisation Strategies and Action Plans in comparison to the RIIO-2 companies and therefore agree with the proposal to potentially increase the expectations on DNOs for ED2.

We have copied below our comments that we made for our response to the RIIO-2 draft determinations[52].

> "We strongly support Ofgem's incorporation of the Energy Data Taskforce's best practice principles into RIIO-2. To deliver value to consumers, it is imperative that data strategies are regularly reassessed to unlock the network efficiencies and service improvements that are possible through better accessibility of data sets for relevant stakeholders.
>
> We support the Licence Obligations for the Digitalisation Strategy and Data Best Practice. The Licence Obligation should ensure compliance with

[52] Citizens Advice, Response to RIIO-2 Draft Determinations for Transmission, Gas Distribution and Electricity System Operator, 2020

Data Best Practice guidance. We welcome the opportunity to contribute to the future consultation on the design of the Data Best Practice guidance and further welcome the inclusion within the Licence Obligation of the principle of Energy System Data as being 'presumed open'.

As proposed, both licence conditions are framed to aid "*delivery of an energy system that meets the requirements of the UK targets for Net Zero carbon emissions at the lowest possible cost to consumers*"[53]. We think this a highly appropriate aim. However, it is vital that the vision for a more open and innovative system for energy data is linked to the delivery of consumer outcomes and not just greater efficiency. The delivery of service options, forms of service support, consumer access to data and the usability of systems are all vital to consider as part of planning for digitalisation and data strategy. Digitalisation is also an opportunity for networks to deliver a step change in the way they support consumers in vulnerable circumstances. The various vulnerability projects and NIA funding objectives can be better met by a coordinated approach to better managing consumer data to support service provision.

Digitalisation of energy enables the creation and sharing of more data to support the delivery of an informed and innovative energy system. Information about consumer circumstances and energy consumption will arguably be equally as important as system data in determining how to create a modern and sustainable energy system. We fully accept that there are additional challenges around privacy and ensuring that people can control how their data is accessed, shared and used, as outlined in more detail in our recent report Clear and in Control[54]. In order to, to deliver networks that meet the needs of consumers it will be essential to provide opportunities to safely access, use and share consumer data to support a more informed and innovative energy system.

Targeted consumer support from networks is only as good as the data that underpins it and in energy this data should be better. As outlined in our response to vulnerability questions in this response, the Priority Service Register (PSR), data sharing with energy suppliers, support services, other energy networks or utility services could improve

[53] Ofgem, RIIO-2 Draft Determinations Core Document, p29
[54] Citizens Advice, 'Clear and in control: Energy consumers' views on data sharing and smart devices', November 2019

consumer engagement with their services. This should be an area to consider for future NIA projects."

The CMA, in its provisional findings in response to the PR19 appeal recognised that "*there appears to be scope for regulators and companies across the water sector and across utilities to share experience of developing registers, and their approach to developing the criteria for inclusion.*"[55] There are a range of other outcomes that may be achieved through a mechanism for consensual data sharing. For example, asset registration data can help shape the network response to keeping that asset on supply. As a further example, the prioritisation of assets for consumers in vulnerable situations would reduce a high risk of detriment in going off supply.

Following our response to strategic investment, it may also be appropriate given the particular centralised or decentralised network utilisation priorities to factor in, with consumers' permissions, how to tailor network access and charging options to meet local and regional consumer needs. Network digitalisation strategies and better data sharing should ensure options created by access and settlement reform can be used to deliver consumer outcomes.

DSO transition

OVQ17 Do you agree with the proposals we have set out to support optionality for wider institutional change should we later decide to separate DSO functions from DNOs? How else could the methodology support optionality?

We note that the SSMC[56] (page 55) is not consulting on the separation of DNOs from DSOs. We understand that the development of DSO functions within DNOs is ongoing and that, for practical reasons, it is reasonable to not seek separation at present. We would welcome further consultation on this matter during ED2 as the DSO functions become established so that this issue can be considered by stakeholders.

With respect to the proposals to support optionality for wider constitutional change we have the following comments.

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[55] Competition and Markets Authority, Anglian Water Services Limited, Bristol Water plc, Northumbrian Water Limited and Yorkshire Water Services Limited price determinations Provisional findings, Sept 2020
[56] Ofgem, RIIO-ED2 Methodology Consultation Overview, July 2020,

Separation of revenues and costs for DSO functions

We note that the DNO and DSO revenues are intended not to be separated during ED2 and efficiency rewards would be available for DSO revenues under the TIM. We believe that is not an optimal solution to support future optionality nor does it assist in identifying clear boundaries between DNO and DSO costs and functions. As noted in the SSMC at page 62, when discussing the proposed ex post incentive, there may be a risk of companies moving costs between categories to ensure the best result from different incentive mechanisms. **We therefore recommend that costs and revenues are separated for DSO functions for ED2.** This would aid in cost transparency between DNOs and would also assist in identifying different DNO abilities to achieve DSO efficiencies. A DSO 'TIM' could be used for the separate DSO revenues which could have a different sharing factor from the DNO TIM to drive faster efficiencies in this relatively new activity for DNOs. Use of a separate TIM for DSO would require a close costs assessment of the DSO baseline values to ensure that they are accurate and reflect value for money. Although, this should also be undertaken whether the DSO costs are separate or within a DNO's baseline allowances that incorporate both DNO or DSO costs.

Interoperability, standardisation, and costs

We welcome the continued drive to ensure interoperability and standardisation of processes across DNOs for DSO functions, which should aid in any future separation of roles or move to a third party or parties for these functions. We note that Ofgem are seeking to isolate costs associated with flexibility using new costs reporting templates. **We would recommend that all DSO-related costs are captured for each DNO to enable cost transparency and comparison between DNOs and to more readily enable future separability, if needed.**

Further actions possible within the ED2 period

We note that Ofgem is prepared to take necessary actions to reassign functions within the ED2 period, and that Ofgem will be further defining and developing the necessary tools to enable this. We welcome this development and understand that there may need to be a DSO re-opener to facilitate any move of funding and to adjust any associated outputs for DNOs within the ED2 price control period. We note the continued scoping of this re-opener and would welcome further consultation upon this in due course. **The reassignment of any DSO functions, however, will require detailed knowledge of associated revenues and costs for those functions, and therefore we reiterate our recommendation to separate revenues and costs for DSO functions.**

Ofgem also needs to put in the building blocks now to gather evidence for the assessment of any future formal or legal separation for the DSO functions and **set a clear timeline for this assessment** so that companies and stakeholders know what is intended.

OVQ18 Do you agree with our proposal to use the Business Plan Incentive to encourage companies to reveal standards of performance higher than our baseline expectations in their DSO strategies? Do you agree we should require, where appropriate, all DNOs adopt these revealed standards?

We welcome that DSO Strategies are to be reviewed as part of the assessment of Stage 1 of the BPI as we believe that the DSO functions will be critical to the development of an efficient and smarter energy system to deliver Net Zero. We support the use of the Consumer Value Proposition incentive so that companies that demonstrate standards of performance or cutting edge ideas for DSO functions, can be rewarded to undertake those activities. **We recommend that those ideas that are identified during the business planning process or during the Business Plan submission which are of universal application become requirements for all DNOs and funded within DSO baseline allowances.**

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

DSO functions are a relatively new and developing area. We therefore welcome the proposal to invite companies to provide metrics and performance benchmarks within their DSO strategies that could be incorporated as common metrics. There will need to be further stakeholder consultation with a wide range of input to evaluate these metrics and benchmarks.

The status of company proposed metrics will need to be made clear to ensure that there is no confusion on targets. Experience from the ESO incentive scheme suggests that while some performance measures may be entirely within the company's control (for example, in relation to promptness and accuracy in billing), others may be only partially in their control (for example, in relation to encouraging competition and plurality, where the actions of others may be just as, or more, important). There may therefore be a need for the application of subjectivity and judgement in assessing performance in some areas, rather than applying wholly fixed targets. Experience of the ESO scheme has also suggested that networks will naturally find it easier to propose metrics that are easily measurable - but that these may not reflect where they can add best value. It will be important that Ofgem is clear on the relative weight it gives differing metrics and the balance between objective targets and subjective assessments.

One advantage when compared to the ESO incentive scheme is that there are multiple DSOs. While differences in the areas they serve may frustrate full like-for-like comparison, it should nonetheless be much easier to benchmark their performance against each other. We would encourage Ofgem to try and develop common metrics where it is appropriate to do so. It may also be worth considering whether the availability of relative performance data provides an opportunity for determining rewards or penalties (for example, through league tables).

OVQ20 Do you agree with our proposal to introduce a DSO ODI in which we would, via an ex post incentive, penalise or reward companies based on their delivery against baseline expectations and performance benchmarks? If so, what criteria and other considerations should we take into account in determining whether we should apply a reward or penalty?

We would also refer you to our response to OVQ17. In the ED2 SSMC proposals, there is intended to be no separation between DNO and DSO revenues so that the TIM will operate across all of these costs. As we stated in OVQ17, we do not believe that this is an optimal solution to facilitate cost transparency, identify relative efficiencies for DSO functions across companies, or to prepare for future separation, if required. We outlined our views on the benefits of such functional separation within our response to the Ofgem DSO Position Paper[57]. **We would therefore advocate for revenue and costs separation for DSO activities, including the use of a separate DSO TIM if needed.** A DSO TIM could have a different sharing factor from the DNO TIM to drive faster efficiencies in this relatively new activity for DNOs. Use of a separate TIM for DSO will require a close costs assessment of the DSO baseline values to ensure that they are accurate and reflect value for money and calibration to ensure that the sharing factor drives the correct behaviours.

Any additional incentive mechanism for DSO functions beyond the TIM (whether for separate DSO revenues or blended DNO/DSO revenues) will potentially duplicate rewards for the same activities and efficiencies. Therefore any further DSO incentive mechanism must ensure that it only rewards or penalises DNOs for specific activities which are clearly outlined.

[57] Citizens Advice, Response to the Ofgem Position Paper on DSO: Our approach and regulatory priorities, October 2019

We note the aim to update the baseline expectations for DSO functions following the submission of Business Plans and assessment of penalties and CVP rewards. We support this aim to ensure that the best practices of the DNOs are incorporated within the baseline expectations of all companies to drive improvements and consistency across the sector.

For a DSO-specific incentive, we support the ex post nature of the mechanism, including the qualitative nature of many of the factors that will need to be assessed. Therefore we would support the use of an independent assessment panel for this incentive mechanism as is undertaken for the ESO. Panel members will need to include those with distribution-level knowledge to understand issues relating to end users and stakeholders that may be smaller community groups or businesses, local authorities and councils, or individuals.

It may be appropriate for a single performance panel to consider the performance of all DSOs, rather than establishing a separate panel for each, for multiple reasons. Firstly, because it would allow for peer group comparison, for example for the performance of one network to be considered in the context of how the others are doing, which may aid the assessment of how stretching its performance is. Secondly, because it would likely aid consistency in marking. Finally, because it would reduce the resource burden and cost that would be incurred in running separate panels.

The consultation is not clear on what the status of the evaluation at the halfway point of the price control is: whether it would result in a financial reward (or penalty) in its own right; or whether it is there simply to indicate a direction of travel (so that a network has a sense of whether it is on a pathway to reward or penalty at the end of the price control). This point could be usefully clarified. Given that this incentive regime is new and that understanding of what works, or doesn't, in scheme design is likely to rapidly evolve, Ofgem may wish to - or need to - consider resetting the metrics at a mid-point review. This would tend to suggest that any assessment at that point should result in a reward or penalty at that point, rather than it informing the end of price control assessment.

We would recommend the following when considering how to assign rewards for those activities that go beyond the minimum requirements of the roles, principles and expectations and to penalise where the activities fail to meet the minimum requirements or the stated additional aims of the relevant DSO Strategy:

- **Using those ESO incentive reward and penalty measures that are applicable to DSO functions to ensure consistency between the sectors and to take the best practice from the ESO assessment mechanism**
- **Using a single common assessment panel for all DSOs**
- **To reward or penalise those measures which may be specific to DSO functions which could include:**
    - **The design and implementation of DSO activities that aim to address distributional impacts, inclusivity, and effects that may be detrimental to consumers with vulnerabilities**
    - **Activities that aim to encourage participation in flexibility markets including those targeted at community groups or consumers that may be less likely to participate due to lack of knowledge**
    - **Stakeholder satisfaction with DSO activities. This could be a separate new survey requirement with information gathered from those tendering or contracting flexibility services or from other stakeholders that are active in the market or intend to be, or those using the forecasting or other constraint information services supplied by DNOs, for instance**
    - **Efficiencies identified and shared with the sector**

We support the proposal that this may be an asymmetric mechanism, so that achieving a baseline expectation achieves no reward, but that failure to achieve it could result in a penalty.

OVQ21 Do you agree with our proposal to undertake that ex post incentive performance assessment in the middle and at the end of the price control? Do you think the assessment should be more or less regular?

We note that it is proposed for many of the ED2 incentive mechanisms to be assessed at the mid point and at the end of the price control. While this may be more suitable where there is a good track record of performance and reporting over many years, it appears to be unsuitable to have so few reviews for a developing and new set of functions for the DNOs. If the first review was only at the mid point of the ED2 price control, there would be no assessment of progress to meet the DSO Strategies and plans until 2025. While the DSO Strategies will be assessed at the Business Plan submission stage, these are purely strategies and whether their strategies are fulfilled appropriately would not be addressed for a long time into the price control under this proposal. As such, any failings to deliver these DSO strategies will go unidentified for a considerable period of time with rectification only likely after review and into

2026. Annual reviews offer the opportunities to highlight problems earlier as well as identify best practices that could be rolled out across all DNOs as rapidly as possible.

The ESO assessment has been at 6 monthly intervals as it develops its programme and it is intended to move to annual assessments. It would be consistent to have these new DSO functions subject to similar frequent scrutiny in these early stages of development.

We are, therefore, recommending annual DSO incentive assessments, which would include the use of an independent assessment panel staffed with personnel with appropriate knowledge of distribution level activities and the needs of the end users in the DNO licence areas.

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

We note that an approach proposed by Ofgem is to set appropriate incentive values in a similar way to the ESO using baseline values. However, as Ofgem states, the baseline values for the DNOs would have to be ring-fenced to only include those that are relating to DSO functions. We would advocate (as we have noted elsewhere in the responses to the DSO questions) to have separation of DSO revenues and costs from DNO revenues and costs, with clear boundaries showing the allocation of costs between the DSO and DNO activities to aid in clarity of these DSO baseline values. Without clarity of what should be in DSO values, there is a risk of inconsistency between DNOs in what they categorise as DSO or DNO, and even a possibility of movement between categories to gain the most appropriate incentive rate or to avoid penalties (as Ofgem acknowledges).

The alternative of using assumed DSO costs across companies may reduce this risk but it is a poor substitute for using the actual DSO costs as provided by DNOs, and may leave some DNOs winners, while others are losers. Using an averaging figure (e.g. percentage of baseline revenues) appears inappropriate as there may be similar cost structures to run DSO activities at DNOs that are irrespective of the size of the baseline values for the DNO. As such, larger DNOs may be over-rewarded while smaller DNOs may risk being under-funded. Using an absolute value relative to baseline values may be more appropriate but the calculation of this absolute value will require calibrating against another set of values, presumably the DNO submitted costs for DSO activities. Therefore it would be better to use actual submitted costs as the baseline for calculating the reward and penalty values.

In summary, we would recommend calculating the rewards and penalties for the DSO incentive against the actual baseline costs for DSO activities. However,these DSO costs should be clearly stated, consistent across DNOs, and separate from DNO costs so that there cannot be any ongoing movement across categories (unless subject to Ofgem scrutiny and approval).

We note that Ofgem is considering different options for how to treat deliverables and performance benchmarks in determining rewards and penalties. We understand that DNOs have been asked to submit ideas for metrics for this benchmarking which may aid in this determination. We note that a single, holistic approach with a single reward or penalty is also being considered. At this stage, without seeing any detail of potential individual benchmarks or metrics, it is difficult to assess whether individual element assessment or holistic assessment is preferred, however, at this early stage of DSO assessment, the holistic assessment option may be more useful to accommodate the uncertainties of assessment mechanisms, and to allow time for the benchmarks and metrics to prove valuable or otherwise.

OVQ23 Do you agree with the DSO roles, principles and associated baseline expectations in Appendix 5? Does it provide sufficient clarity about the role of DNOs in RIIO-ED2? Do you think amendments or additional baseline expectations are required?

We support the clarity in laying out the principles, roles, and baseline expectations of DNOs as described in Appendix 5. This is a welcome feature in the development of the DSO functions within DNOs. The principles and expectations will help to provide consistency in DSO activity across the 6 DNO companies and lessen the risk of a postcode lottery in the development of a smarter electricity distribution system across GB.

However, we note that within the principles and expectations detailed within the Appendix 5 and at Chapter 6 of ED2 SSMC covering DSO transition, there is no requirement for taking into account any distributional impacts, or the needs of those that may be more likely to be excluded from the transition, such as those in vulnerable circumstances. While ED2 is proposing to include energy transition considerations within the requirements of a DNO's Vulnerability Strategy, we believe that there should be a read across to these activities within the requirements of the DSO Strategy. As such, **we recommend that considerations of the distributional impacts on consumer groups of DSO**

activities, as well as inclusivity and how the DSO Strategy meets the needs of the more vulnerable in communities should be included as a requirement within the DSO roles, principles and expectations.

Role 2 (Network operation) for Principle 1.1: Plan efficiently in the context of uncertainty taking account of whole electricity system outcomes, and promote planning data availability states:

> "We expect DNOs to identify and use new operability tools and approaches that minimise network losses and maximise the efficiency of network capacity. This includes smarter use of existing assets, the promotion of the uptake of energy efficiency measures where this cost effectively alleviates the need to upgrade or replace electricity capacity and supports the efficient and secure operation of the distribution system, and deployment of flexibility."

It is not clear how this promotion of energy efficiency is to be undertaken by the DNOs or which types of energy efficiency are to be included. Similarly, it is not obvious how the energy efficiency promotion costs can be compared with other expenditure alternatives such as using flexibility services or traditional reinforcement. **We would ask for additional information about this requirement including:**

- **Details of the appropriate types of energy efficiency that can be included in this requirement**
- **How the costs of promoting energy efficiency can be calculated and compared with flexibility or reinforcement costs**
- **Whether the DNOs will be using the same Cost/Benefit Analysis (CBA) to undertake this work to ensure consistency across the sector.**

We would recommend that further consultation or other working group activities are undertaken, coordinated by Ofgem, to understand the requirements of this principle and to ensure that the DNOs establish a consistent framework and a methodology for any CBA which includes the promotion of energy efficiency as an alternative to other cost elements such as flexibility services or reinforcement. It may be necessary to undertake trials to establish appropriate working practices and parameters to meet this expectation. **See also our recommendations within our response to the BEIS Call for Evidence on Facilitating Energy Efficiency in the Electricity**

System, September 2019[58] at page 6. The most relevant passage is repeated below:

> **"At present, therefore, there appears to be uncertainty in understanding how energy efficiency could fit readily into current network option assessment and price control mechanisms. The network companies will need a consistent, observable and measurable way of integrating energy efficiency into their network design and modeling analysis tools. Energy efficiency would need to be given parity with other solutions as well as have an agreed and quantifiable method of calculating benefits. There are also potential risk increases to networks from using energy efficiency measures as an alternative to network reinforcement. Finally, network companies would need to be able to prove additionality as a result of their actions.**
>
> **To resolve these uncertainties, we would recommend further real-world trials, including cost/benefit assessments, to be undertaken to better calculate the rewards of energy efficiency versus network reinforcement or another mechanism such as flexibility. It would also be useful to better understand the potential role of networks in delivering energy efficiency improvements as it may be preferable for an independent third party to be the energy efficiency delivery partner.**
>
> **We would also recommend stakeholder consultation by Ofgem and the Energy Networks Association to identify incentive mechanisms and cost/benefit analyses that would be appropriate for networks if they appear to be the appropriate conduit for driving energy efficiency by third parties. These mechanisms would need to ensure an even-handed approach when considering energy efficiency versus other options. Consultation with stakeholders would also help to clarify the risks involved with networks' usage of energy efficiency for network reinforcement options' analysis, including timing differences, potential conflict issues, and the need for transparency."**

We note that within the roles and principles there is a baseline expectation that DNOs will provide information on constraints and other operational data so that

[58] Citizens Advice, response to the BEIS Call for Evidence on Facilitating Energy Efficiency in the Electricity System, September 2019

relevant stakeholders can make better decisions about how to use the network. DNOs are also expected to be neutral facilitators to develop flexibility markets and provide accurate, user-friendly and comprehensive market information to assist stakeholders to participate in these markets. We are supportive of all these requirements. We understand that some DNOs are undertaking proactive efforts to explain the practicalities and opportunities of participating in flexibility services and to develop understanding in groups that may be less knowledgeable about the flexibility markets. These groups can include community energy groups, and social housing associations, for instance. **We recommend that DNOs are required to undertake proactive educational work with less-knowledgeable groups or consumers so that they may have a more equal opportunity to participate in the flexibility markets.**

A Whole system approach

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

We welcome the focus upon whole systems solutions within ED2. We believe it is valuable to have whole systems proposals by DNOs to be included within the BPI assessment, as well as whole systems considered within the innovation programmes, and the use of the CAM re-opener. We welcome the broad definition of 'whole system' to expand the scope to apply not only to gas and electricity but also to other areas, such as transport, water and waste, for instance.

We have previously noted the potential importance of energy efficiency when considering a whole systems approach. We refer you to the following consultation responses where we outlined our views regarding energy efficiency:

- Citizens Advice response to the BEIS Call for Evidence on Facilitating Energy Efficiency in the Electricity System, September 2019[59]
- Citizens Advice response to the Ofgem Open Letter on the approach to setting the next electricity price control (RIIO-ED2), October 2019[60]

[59] Citizens Advice, response to the BEIS Call for Evidence on Facilitating Energy Efficiency in the Electricity System, September 2019
[60] Citizens Advice, response to the Ofgem Open Letter on the approach to setting the next electricity price control (RIIO-ED2), October 2019

In these papers we recommended that there should be consideration given to incorporating energy efficiency measures within the cost benefit analysis of infrastructure decisions, and to consider undertaking trials to evaluate how best to incorporate energy efficiency measures within DNO operations and decision-making. We note within the proposed roles and principles for DSO at Appendix 5 of the Overview Document, that DNOs are expected to "identify and use new operability tools and approaches that minimise network losses and maximise the efficiency of network capacity. This includes smarter use of existing assets, the promotion of the uptake of energy efficiency measures where this cost effectively alleviates the need to upgrade or replace electricity capacity and supports the efficient and secure operation of the distribution system, and deployment of flexibility."

We welcome the focus upon energy efficiency within the DSO principles, however, **we would ask for more information regarding how energy efficiency promotion is to be undertaken within DNOs to meet this principle's expectation. See also our response to OVQ23 above which also addresses this point in more detail and makes recommendations on the topic.**

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

Whole systems solutions and planning is particularly relevant at the electricity distribution level given the DNOs vital role in their local communities for transport, heating, and in energy for water and sewerage services. We note that the DSO Strategy is proposed to be reviewed as part of the Stage 1 of the BPI assessment. The DSO Strategy, and DFES forecasting should incorporate whole systems as part of its development and we are aware of many DNOs having undertaken planning in concert with their local gas companies and local authorities or regional stakeholders. Whole systems thinking will also be relevant in considering innovation projects. **We therefore believe that evaluation of whole systems thinking by DNOs should consider DNO proposals reflected within the DFES and forecasting plans, the DSO Strategy, the Vulnerability Strategy, any relevant CVPs, and in the innovation projects proposed by DNOs.**

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

We support the whole systems focus within the innovation stimulus. We had comments regarding some of the innovation package in our response[61] to the draft determinations for the transmission and gas distribution sectors. We have repeated below our comments relevant to the SIF and NIA schemes:

> "We note that there will be further work and consultation to develop detail regarding the SIF and acknowledge the list of issues for consideration including defining 'innovation'.
>
> **We would recommend that the following aspects be included in these considerations for the SIF:**
>
> - **A focus on distributional impacts and inclusion for consumers with vulnerabilities and low engagement with energy.** The description of the SIF does not provide any specific processes to address these issues and we would ask that all projects have these considerations included within them as we also highlighted within our response to the Sector Specific Consultation Methodology.
> - **We believe that there should be a high bar for approval of projects,** as these innovation projects are being funded via the existing use of system charges methodologies and therefore socialised across GB consumers. **Affordability may be an increasing concern due to the likely economic impacts of COVID-19**[62] and the potential benefits must be clear and of significant value.
> - There may be a need to develop new robust cost and benefit analyses to assess these projects including the social benefits that may accrue to consumers, including those consumers with vulnerabilities. **We recommend the inclusion of the SROI methodology,** when finalised, in these analyses.
> - **We would welcome further information regarding how the percentage of funding that will be borne by consumers or companies is decided.** At present, Network Innovation Competition (NIC) funding is shared 90% to consumers, 10% with company participants. The SIF fund percentages will be decided on a case-by-case basis according to this proposal and we would welcome information regarding how certain projects would attract different percentages of consumer support compared to others

[61] Citizens Advice, response to RIIO-2 Draft Determinations for Transmission, Gas Distribution and Electricity System Operator, September 2020
[62] Citizens Advice, Meeting Net Zero - Options for network company highly anticipatory investments in a post-COVID-19 environment, July 2020.

and the criteria used for these allocations. It would be useful to know, for instance, whether the likelihood of success, or extent of consumer benefit compared to the cost may be relevant factors in such a decision.
- **There was no specific mention of IDNOs or IGTs** and while these companies may be included as 'third party' partners, we would welcome stated consideration of these companies to ensure an inclusive approach to innovation funding.
- Assessment of the SIF funding and its outcomes may necessarily take some time to realise, however, **it is important to include an evaluation of individual projects and the scheme as a whole,** to assess its value and whether it has met its objectives.

We are supportive of the continuation of the **Network Innovation Allowance (NIA)** scheme and many of its design parameters including the proposed size of the funding for most networks. However, we believe that providing only 2 years of NIA funding for the ESO isn't sufficient given the scope of wider consumer benefits.

This fund needs to enable continued innovative solutions which the market alone might not provide. We welcome the focus of the NIA fund on longer-term energy system transition challenges or consumer vulnerability issues. In particular, we support the new proposed new reporting framework and requirement of the impact assessment to consider the expected effects of the innovative solution upon consumers with vulnerabilities.

We have the following recommendations relating to the NIA:

- **The NIA reporting framework should require all companies to collaborate with partners,** as set out for the ESO. This should support stakeholder expert engagement and encourage cross-sector and whole system considerations.
- **The reporting framework should highlight where projects have collaborated across the different energy sectors** and led to whole systems solutions, as well as detail the partnerships and why they were chosen.
- **Potential partner consideration should include community groups, social housing groups, local authorities and academics.**

- **The proposed reporting framework should include robust dissemination procedures** to ensure that the lessons learned are able to be used by other industry companies and sectors, and within the wider community.
- **Ofgem should set out clear guidance on the boundaries between funding projects** relating to vulnerable customers via the NIA and the UIOLI allowance."

We note that the ENA is developing a joint gas and electricity strategy which incorporates whole systems thinking, which we welcome. We recommend that Ofgem tasks the ENA with developing a more inclusive 'whole systems strategy' to incorporate transport, water, and sewerage services, among topics for consideration.

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

We note that the CAM is expected to operate in ED2 in line with the RIIO-2 draft determinations proposals. As such, we have repeated our comments below from our response to the RIIO-2 draft determinations consultation response[63]:

> "We welcome the introduction of the Coordinated Adjustment Mechanism (CAM), that can facilitate whole systems solutions through transferring a project from one licence holder to another where there are clear consumer benefits. We note that Ofgem intends to introduce a CAM licence condition, which we support, and welcome the intention for further engagement on CAM guidance with stakeholders. We also welcome the ongoing work being carried out through the Energy Networks Association (ENA) to develop a methodology for whole system cost benefit analysis which will support the CAM.
>
> We understand the rationale for not setting a materiality threshold for such transfers given that the costs for the project are set at the outset of RIIO-2, that consumers will benefit from such a transfer, and that companies will be dis-incentivised from trivial applications due to resource costs. It may be suitable to monitor the extent and value of CAM applications during RIIO-2 to assess whether a materiality threshold would be appropriate if there are many small projects with low consumer benefit from the transfer.

[63] Citizens Advice, response to RIIO-2 Draft Determinations for Transmission, Gas Distribution and Electricity System Operator, September 2020

> We note that there is not intended to be a financial incentive for the CAM. Network companies repeatedly tell us that they are focussed upon 'Doing the right thing' and therefore a financial incentive should not be necessary to facilitate a project transfer which is in consumer's interests. Network companies' abilities to agree a compensatory value between transferring companies for any issue relating to a reward or penalty under the Totex Incentive Mechanism (TIM) appears appropriate.
>
> We agree with the proposal to not have a 'foreseeable' criterion for the reasons outlined in the consultation, namely that this may be an additional burden in the application process with little gain for consumers as there should have been sufficient scrutiny at the project's initial application to assess foreseeable issues.
>
> We note that Ofgem intends to introduce a CAM licence condition, which we support, and welcome further engagement on CAM guidance with stakeholders.
>
> We believe that it would be efficient to have the receiving company as the lead applicant with the passing company as the supporting secondary applicant."

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

We have no firm views regarding the application window frequency except to comment that there may be an additional administrative burden upon Ofgem and companies with more frequent applications. There will be a necessary tension between being responsive and the costs of the process and believe that this should be borne in mind.

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

We believe that there is value if the CAM was to be part of the current ED1 licence to allow for transfer of projects between sectors prior to 2023.

Access SCR

OVQ30 Do you agree with the impacts of our potential Access SCR proposals that are identified in this Chapter? Are there additional impacts that are not identified?

The Access SCR will significantly change the way consumers use electricity. It will mean a particular consumer's access to energy and the cost of energy through their choice of asset can vary. For example, varying access and cost based on the timing, location and quantity of energy required. This will need a broad range of measures to ensure a positive distributional impact across consumer groups and to protect consumers from detriment, as outlined in our response to the Marketwide Half Hourly Settlement Impact Assessment[64]. Our research from Traverse also highlights that it can't be assumed that consumers in vulnerable situations can significantly alter their energy behaviours without risk of detriment[65].

To protect consumers during this process, the use of personal data about energy consumption characteristics needs to be controlled easily and holistically by consumers or their chosen intermediary to encourage engagement and protect their interests[66]. We think this means through ED2 and Access SCR, there is a clear need to ensure that networks' increased use of consumer data is well structured to facilitate transparency and access to the data for consumers. This includes consumers' smart meter data, property details, asset register information, priority service information and potentially further detail on consumer energy preferences. Policy targeting, such as Green Home Grant may well benefit from this real data if easily accessed by consumers in future.

Decisions made about how a consumer's details and consumption characteristics are used by networks should follow an objective and transparent process defined by Ofgem to provide accountability and fairness to the process. This includes important functions including settlement, forecasting (including network resilience and investment planning). Where this is not the case a consumer should have the opportunity to rescind data access and access forms

[64] Citizens Advice response to '<u>Electricity retail market-wide half-hourly settlement: consultation</u>', September 2020
[65] Citizens Advice, <u>Understanding high and low electricity usage</u>, July 2020
[66] Citizens Advice, <u>Clear and in control - Energy consumers' views on data sharing and smart devices</u>, January 2020

of redress. Existing flexibility contracts with DNOs should equally have access to these protections.

Clarity on when and how a holistic view of consumers' energy profile can be used to shape local and regional consumer outcomes in the Access SCR is a key element of ED2 as it determines the forms of evidence a network can use to make network planning or investment decisions. It is vital that how local and regional energy systems use consumer data to provide tailored networks that better meet consumer needs has standardised and clear energy data governance. Without these processes it leaves consumers highly exposed to network judgements about when and how to use consumer data.

Further, we recognise that changes to the Access SCR may have impacts on DNOs' business planning, particularly if there are changes to the Connection Boundary, including further socialisation of connection costs, encourages greater numbers of connections at the distribution level.

These changes could also impact upon some of the mechanisms that have been proposed to manage uncertainty with the ED2 price control. For instance, there are 2 volume drivers that have been proposed to manage the uncertainty associated with increased demand for LCTs, an LCT volume driver and a capacity volume driver. The LCT volume driver does not appear to address the implications from Access SCR changes which could accelerate connections to the distribution level that are not necessarily due to the LCTs mentioned e.g. EVs or heat pumps. As such, the LCT volume driver may be less suitable to reflect capacity changes on the DNOs' network compared to a different form of capacity driver.

We note that Ofgem is considering allowing connection charges to be paid over time. **We would welcome further consultation regarding this aspect of connections' payments, as such a change would increase the credit risk to DNOs due to the potential default of connected businesses.** It may also encourage more connections' applications where the financial standing of the business is not sound.

DNOs have already entered into many flexible connection contracts with businesses. These contracts allowed for a cheaper initial connection in exchange for the right of the DNO to unilaterally limit supply to the business (sometimes with limitations to the number of such interruptions). In many cases, these contracts are in perpetuity. **We believe that it may be in consumers' interest**

to have such contracts reconsidered as the businesses may not have been aware that their flexibility may have had value in the market, or the flexibility market may have evolved since the contract was entered into. Stakeholder engagement and analysis would be welcomed to assess the impact on the efficient operation of the flexibility markets of these pre-existing flex connections' contracts and whether there should be amendment of these contracts.

OVQ31 Do you agree with the proposed Access SCR baselines for the RIIO-ED2 business plan submissions (ie that Draft RIIO-ED2 Business Plan submissions should use Access SCR Minded to Consultation as a baseline, and that Final Business Plan submissions should use Access SCR Final Decision as a baseline?)

It appears reasonable to use the Access SCR Minded-to Consultation as a baseline for draft Business Plan submissions, and the Access SCR Final Decisions as a basis for final Business Plan submissions. However, it will be important for the Access SCR schedule to remain on track so that any changes to the Connection Boundary (and other changes) aligns with the start of ED2 as planned. In addition, we recognise that DNOs are better placed to respond to this question as they will have more data to evaluate the implications of using the Minded-to and Final Decisions on Access SCR in the way that Ofgem proposes.

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

No response provided.

OVQ33 What further guidance might be required from us to allow DNOs to identify the parts of their draft Business Plan submissions that could be impacted by our Final Decision of the Access SCR?

No response provided

COVID-19

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

See also our response to OVQ4.

The COVID-19 pandemic appears to have impacted many consumers negatively to date, and we are aware that the full implications will not be known for some months or even years. However, it's already clear that issues around consumer affordability will have become more acute and that there may be changes to types of vulnerability, e.g. for those that were asked to shield, and depending on the course of the pandemic, may be asked to do so again.

As we stated in the Executive Summary and repeat here, 1 in 9 people, the equivalent of 6 million people nationwide, has fallen behind on a household bill because of coronavirus[67]. We would ask that Ofgem considers its approach to baseline funding for ED2 to factor in the likely dampening in consumer willingness to pay due to COVID-19. The scale of this impact should be reflected, not just in more efficient baseline funding, but across the whole price control proposal. COVID-19 is also having a wider energy system impact driven by more home working, depressed demand for energy on the system overall and new demand profiles[68]. The costs of responding to these changes is likely to impact consumers,[69] alongside higher unemployment and redundancies, increasing consumer debt, and general pressure on household incomes.

These issues could have potential implications for the operations of DNOs over the price control period. For example, they could potentially lead to less investment in some areas due to demand changes, reduced consumer willingness to pay for new projects, and potentially less ability or appetite for consumers to support extensive infrastructure expansion.

There are a number of UMs, including re-opener mechanisms that have been proposed within this consultation, however, **we would recommend that a specific COVID-19 re-opener mechanism is considered to allow for adjustments to baseline or other revenues as better information is gathered on the implications for network operations.**

[67]Citizens Advice, Six million fall behind on bills because of coronavirus, August 2020.
[68] National Grid ESO, The actions we're taking to manage reduced demand for electricity this summer, May 2020.
[69]Balancing costs are up to £718 million over March to July, which is a 39% year on year increase Ofgem, Open letter our review high balancing costs during spring and summer 2020, 2020.

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