

RIIO3@ofgem.gov.uk

15th January 2025

Dear Steve,

SP Energy Networks (SPEN) response to Ofgem's Framework Consultation: electricity distribution price control (ED3)

SPEN welcomes Ofgem's framework consultation on the next electricity distribution price control (RIIO-ED3) at this critical time when we are working towards delivering on the ambitious net zero and Clean Power by 2030 (CP2030) targets set by the UK and devolved Governments.

Whilst much of the focus recently has been on developing the transmission spine of the future energy system, Distribution Network Operators (DNOs) are just as critical to GB's energy transition and security of supply, and are essential to local communities and customers in their ambition to realise economic growth from the electrification of heat, transport and industry. DNOs also play a key role in the resilience of our future energy system, including by supporting the recovery of the transmission network in the event of system wide event.

The scale of the challenge ahead is extensive. Energy demand is set to rise significantly, requiring timely and proactive investment to meet future needs if we are to have any chance of reaching net zero without consumers facing barriers to installing low carbon technologies. The Clean Power Action Plan published by the Department for Energy Security and Net Zero underscores this urgency, highlighting the need for significant distribution network reinforcement to support electrification and new infrastructure, such as data centres and transport hubs.

We support Ofgem's position that the risks and costs of underinvestment and delays to infrastructure build are significant, while the likelihood and risk of overinvestment is low. We strongly agree that ED3 provides an opportunity for Ofgem to establish a more progressive regulatory framework that focuses on proactive network investment and provides an opportunity to lead with ambition, innovation and collaboration – delivering a network that meets the needs and challenges of today and tomorrow.

Key points for Ofgem's consideration

1. Requirement for an evolved RIIO framework to meet the demands of CP2030

As we work towards implementing the ambitious CP2030 targets set by Government, we welcome Ofgem's acknowledgement that challenges such as supply chain constraints, inflationary pressures, and skilled workforce shortages are relevant to both transmission and distribution networks.

The RIIO model, with its focus on outputs and incentives, has been highly successful in driving value for consumers and is recognised as world leading. In RIIO-ED3, Ofgem should look to maintain core features of the model that have been instrumental to its success to date, such as the totex approach, which drives the identification of efficiencies providing benefits to both customers and shareholders.

At the same time, the detail of the framework must also evolve to reflect the new environment in which DNOs will be operating during the RIIO-ED3 period, enabling us to effectively navigate growing global supply chain challenges, grow our skilled workforce, and enhance our ability to combat the worsening effects of climate change.

2. Recalibration of the RIIO mechanisms

Within our detailed responses to the consultation questions, we set out various ways in which we believe the current RIIO framework needs to adapt to reflect the changing RIIO-ED3 environment. These include:

A reappraisal of the effectiveness of the reliability regime

The drive to decarbonise, greater electrification, growing energy demand and highest level of connections ever experienced, all contribute to making the reliability of the distribution network more important to customers than ever.

The Interruptions Incentive Scheme (IIS) has delivered significant improvement in customer reliability, with average CI/CML reducing from 80-90 in 2001 to 30-40 in 2023/24. Over this time DNOs have been rewarded for making these improvements but in recent years the IIS scores have begun to stabilise, and in the first year of RIIO-ED2 DNOs are in an aggregate penalty of £30m. As reliability of the distribution network is more important than ever, it is essential that improvements do not stagnate. We therefore believe that a reappraisal of the effectiveness of IIS may be appropriate. In addition, the effectiveness of all mechanisms relating to reliability should be assessed holistically in order to determine the optimal future reliability framework and incentive regime. Only by reviewing these elements together can an adequate reliability regime be designed that will drive the investment levels needed.

A focus on climate resilience

Alongside reliability, resilience of our networks needs to be a focus of the RIIO-ED3 framework. In order for us to effectively rise to the challenges of extreme weather events and our changing climate, the RIIO-ED3 framework must provide a robust approach to climate resilience. The framework must ensure the 'climate-proofing' of investments, learning lessons from recent extreme weather events such as Storm Darragh. Climate change impacts over an asset's life should be accounted for through design, and include impacts that may only materialise later. We believe that a wider climate resilience incentive should be explored for RIIO-ED3 to improve DNO abilities to withstand, respond and recover from climate events - especially as reliance on electricity grows.

A rebalancing of risk

As DNOs and their shareholders are being called upon to make unprecedented levels of network investment, it is crucial that the regulatory framework is stable, reliable and fair. The framework should not be set in a way which penalises DNOs for factors they cannot control. To this end, examples of regulatory mechanisms that we believe require further assessment include:

- (i) **RPEs:** Supply chain shortages and workforce pressures are contributing to price escalation and volatility above underlying inflation, and the regulatory framework needs to better accommodate this. Whilst the methodology underpinning the Real Price Effect (RPE) indexation mechanism is well-understood, we have material concerns regarding Ofgem's application of this methodology as the indices that are utilised need to reasonably reflect DNO's genuine cost pressures.
- (ii) **Connections incentives:** Whilst we believe it is important for DNOs to provide a high level of service to connecting customers, we also believe that the changing volume and increasingly complex circumstances surrounding connections requests should be reflected in the targets and structure of the regulatory framework, and expectations must be reasonable. To drive improvements, it is also important for DNOs to be rewarded for good performance and not just penalised for failing to meet targets (as is currently the case with the Major Connections incentive).

3. Investability and Financeability

We support Ofgem's recognition that the concept of investability must be integrated into the RIIO-ED3 framework to ensure a regulatory settlement that is investable, financeable and resilient. The scale and pace of investment required in RIIO-ED3 will be unprecedented. Ofgem must establish a regulatory framework that is stable and transparent, effectively supporting this growth while addressing the systemic risks tied to increased borrowing requirements on volatile international capital markets. Achieving investor confidence will be fundamental to RIIO-ED3.

To maintain investor confidence Ofgem will also need to adapt its regulatory financial policies to recognise the different circumstances under which networks will need to raise finance during RIIO-ED3. This includes setting a fair rate of return to help ensure that the sector remains attractive to investors, reflects the increased risks faced by DNOs, and recognises the importance of investability to delivering net zero. Clear, predictable and fair returns under RIIO-ED3 will be crucial to promoting market confidence and protecting the financial stability of private investment.

The key benefits of safe and reliable networks, the facilitation of the transition to net zero and supporting wider economic growth can only be achieved if networks are able to attract both debt and equity finance and are financially resilient. This is in the best interest of consumers and Ofgem should consider how to value and communicate the wide-ranging benefits of investment in electricity infrastructure.

4. Role of the NESO and Regional Energy System Plan (RESP)

It is clear that Ofgem sees the RESP as vital to strategic planning in RIIO-ED3. While we support its intent and recognise the potential for the RESP to be a key enabler of system growth, the lack of clarity on the process, timing, and content raises concerns. Without this detail from the NESO and Ofgem, there is a risk that a transitional RESP (tRESP) product could disrupt the development of robust RIIO-ED3 business plans and the enduring product may undermine the price control settlement.

DNOs need early certainty in RIIO-ED3, and clarity on the tRESP is required now to ensure that business plans are high quality and coherent. We also require clarity on the process and content of the enduring RESP and be reassured that its publication will not fundamentally undermine the RIIO-ED3 price control settlements.

Additionally, DNOs must play a proactive role in shaping and accelerating the development of the tRESP and enduring RESP. This will ensure that suitable measures are in place that adequately reflect the complexity of strategic energy planning, DNO expertise and avoid the delivery of a substandard RESP that could stifle innovation and progress.

The RIIO-ED3 framework represents a pivotal moment for distribution networks as we navigate the challenges and opportunities of decarbonisation, electrification and economic growth. To help DNOs successfully deliver on these goals the framework must support the unprecedented scale of investment while maintaining a stable and predictable regulatory environment that incentivises innovation, efficiency and reliability.

Our detailed response to the framework consultation is attached, and if you have any questions, please contact Caroline Ainslie (cainslie@spenergynetworks.co.uk). We are committed to continuing to work with Ofgem and our stakeholders to ensure RIIO-ED3 delivers a resilient and future-ready network.

Yours sincerely,



Scott Mathieson
Director of Network Planning and Regulation