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Our ref:TC/RIIO-ED3

RIIO3 Team
Ofgem
10 South Colonnade
London
E14 4PU

By email only to RIIO3@ofgem.gov.uk

Dear RIIO3 Team

We welcome the opportunity to respond to your consultation setting out the framework which the RIIO-ED3 price control will follow. BUUK are the leading multi-utility network provider and operate licensed distribution businesses through subsidiaries, the Electricity Network Company Limited and Independent Power Networks Limited. We also operate independent connection provider (ICP) business through separate subsidiaries, GTC Infrastructure and PowerOn. BUUK also operates connection businesses and utility networks across gas, water, telecoms and district heating and this breadth of operation gives a unique perspective across a range of regulatory frameworks and price control mechanisms.

Detailed answers to the questions that Ofgem have asked, where we are able to provide specific input, are appended to this letter. It is well known and understood that UK energy networks are on the verge of a generational change and that substantial development is going to be required on the part of the electricity networks to contribute to that change. It is important that Ofgem sets out a framework for electricity distribution price controls that enables the change in a way that reduces the impact on consumer bills and garners innovative and novel solutions.

Competition has been proven, in a range of scenarios and industries, to be the most effective and efficient way of protecting, and maximising value for, consumers. It is paramount that the network price controls are an enabler of competition in a range of different areas, from the provision of new or reinforced networks, to the procurement of flexibility and other novel solutions to alleviate constraints. Whilst we recognise that some degree of coordination may be required in the future to ensure that government-imposed targets on decarbonising the electricity networks are met, this needs to be balanced with a framework that does not preclude competition from delivering the necessary solutions.

In order to enable this competition to develop we do not believe that Ofgem should be utilising the Plan and Deliver mechanism. The mechanism is inflexible by its design and is likely to foreclose innovation on how to deliver outcomes. There is uncertainty around the most effective method to deliver outcomes because the required outcomes are hard for network companies and NESO to predict, and using a Plan and Deliver mechanism would require

accurate forecasting of changes to network requirements. This may lead to greater inefficiency and unnecessary costs to consumers. Instead, we believe that Ofgem needs to place a greater emphasis on a price control that delivers the right outcomes for consumers with flexibility on the way by which networks deliver these outcomes.

Further, it is important that Ofgem provides clarity and certainty for investors in order to secure the investment need to decarbonise the electricity network. In order to achieve this, Ofgem should continue to rely on an ex-ante price control regulation process which provides clarity to investors of both the outcome and the expected investment. We note that Ofgem is seeking to make changes to the financial ring fence through the RIIO-3 framework and, whilst we can understand the need to review the ring fence, we are concerned that some of the proposed actions do not reflect the risk in the sector, and particularly fail to address some of the differences between independent, multi utility networks and incumbents. We are engaging separately with Ofgem's review of the financial ring fence, but it is important to consider, in setting the frameworks for the RIIO controls, the potential for unintended consequences of unduly burdensome and disproportionate ring fence arrangements.

We would be pleased to engage further with Ofgem in their development of the RIIO-ED3 price control framework and should you have any questions on the contents of this response then please contact me.

Yours Faithfully

Thomas Cadge

Head of Regulatory External Affairs

Q1. Do you agree with our characterisation of the wider context for ED3? Are there any other areas of context that you consider material for ED3?

Yes, we tend to agree with the wider context, RIIIO-ED3 needs to be flexible enough to enable the transition to net zero and support the clean power by 2030 target but also needs to provide certainty for investors to allow them to invest in the required levels.

Q3. Do you agree that the network investment elements of the framework should be more input based?

The network investment needs to take into account development signals from local authorities and government strategy for new housing. Equally, this needs to be couched by the fact that these investments should be funded at the behest of the Developers of these areas. Use of Second Comer processes are in place to ensure a fair return to the original developer and ensure that fair competition can take place for the network ownership.

The framework can and should be input based, but it must ensure that plan does not in any way restrict the competition in the construction, ownership, and operation of infrastructure. This will be necessary to ensure a multi-energy vector approach can be taken. Inputs should be considered part of the planning process but should not necessarily determine the delivery mechanism for outputs.

Q4. Do you agree that we should consider introducing additional controls around network investments and what features should these controls contain?

We agree that it is important to have controls around network investments and these controls should consider broad measures based on customer outcomes. We have seen some difficulty in obtaining connections to networks in some DNO areas because there has been insufficient planning and investment into network reinforcement to enable connections.

Clearly, there will need to be significant investment in networks to be able to resolve these issues but given the greater level of investment we agree that it is important that additional controls are put in place to ensure that investment is made where there is a defined future need for the additional capacity being created on the network.

We note that the new RESP role is likely to increase the level of forecasting and, to some extent, will determine whether or not investment should be undertaken but we are concerned that any level of forecasting will be inherently uncertain and so controls should be in place to allow for flexibility of network investments.

We also think that it is important for companies to have in place network investment strategies which are congruent with their LTDSs and are published such that they can be scrutinised

Transparency and access to load forecasting data will be key to ensure that network investment is undertaken efficiently. Network operators will naturally have a bias towards installing more cables and plant, however, there needs to be a much wider use of Smarter whole system solutions.

Q5. Do you agree that the incentives on DNOs will need to adapt from RIIIO-ED2 and if so, how?

Yes, incentives need to be more reflective of new and changing consumer needs and need to be designed to ensure the correct behaviour from DNO companies in delivering outcomes. We believe that incentives need to consider the outputs required from the price control and network companies.

One area that incentives will need to develop is to ensure that DNOs can be more flexible to changing consumer and network needs. We know that there is still significant uncertainty on what will be required for GB to meet clean power in 2030 and any incentives which reduces the ability of DNOs to be flexible, and to respond rapidly to changing environments will inhibit the transition.

We note, of particular importance to BUUK, the move to the major connections' incentive, in place of the Incentive on Connections Engagements. We believe that this was a positive step in being more holistic in the way that networks engaged with their customers but we believe that this can be further refined to focus on the deliverables that customers' needs and that GB is going to need to see over the course of the RIIO-3 control.

Q6. Do you agree that there is still a role for re-openers in ED3, particularly given the timing of the future full RESP output and how should these be triggered?

Yes, we see the need for re-openers and the ability for changes within the price control. We have made points in answers to other questions in this consultation which recognise that there is difficulty in planning for the exact requirements of a five-year control and that to do so without re-openers would inevitably result in sub-optimal or inefficient outcomes.

However, it is still important to set a baseline expectation of the requirements of network companies which is certain, and which is investable. The framework needs to attract investment into the sector at a quantum which has never before been required and we believe that baseline certainty is likely to be attractive to this investment. Re-openers will be required to meet the changing needs of the networks and consumers over the period of the control but they should not be used at the outset as a means to avoid making the necessary decisions on business plans and investment required at the outset of the price control.

Q7. Using RIIO-ED2 as the counterfactual, what alternative regulatory models or characteristics are needed in ED3 to ensure the DNOs deliver the above consumer outcomes? What are the trade-offs we should consider?

We believe that the RIIO model is generally a good model and has the potential to deliver the right outcomes for consumers and GB. We would not like to see a move too far away from this form of ex-ante price control which allows for a good degree of certainty at the outset but also some flexibility to adapt to the plans.

Q8. Do you agree that the regulatory framework for ED3 should have features of the Plan and Deliver model for network investment and Incentive Regulation model for other elements?

We do not believe that the wide deployment of the Plan and Deliver framework is likely to bring the benefits to consumers of the regulatory incentive frameworks. It relies on high levels of input between the regulator, networks and the NESO and we think that it reduces the scope for innovative, novel, and competitive solutions being deployed to meet the government's targets for clean power.

It is likely to be overly prescriptive in terms of the solution rather than being designed to ensure the appropriate outcomes for consumers. We recognise that Plan and Deliver is likely to give certainty for network companies of costs and delivery of solutions but we question the value that this certainty brings where there is a risk that the network development which is delivered through this mechanism is based on assumptions and forecasts which are, at this point in time, difficult to predict accurately. We are concerned that wide use of the Plan and Deliver Mechanism is likely to 'lock-in' sub-optimal solutions which, when taken in the round, may be inefficient compared to alternatives. This type of regulation will inevitably result in higher costs to customers as it is administratively burdensome, and we believe that it is the most likely to end in sub-optimal solutions for delivery.

Q9. Do you think that there is a greater role for elements of ex post regulation or of cost pass through in ED3, either specifically in assessing cost changes resulting from changes to investment requirements during the period, or more broadly to reflect the changing context?

Cost pass through should only be retained for elements of the expenditure which are truly outside of the scope of control of the DNO. We do not believe that moving to a broader ex post regime or increasing cost pass through allowances is in the interest of customers, or investors as it reduces certainty and may lead to inefficient expenditure.

Q12. Do you agree that the risk and downside for consumers of network underinvestment in network reinforcement would be greater than the downside of overinvestment?

We think that this is a matter of degree, and it is reductive to simply assert that one is a greater risk than another. We would agree that a small over investment is preferable to a small underinvestment insofar as the cost of that overinvestment is likely to be bearable but the consequences of the underinvestment may be significant from some consumers. However, there is significant risk to current and future energy consumers that over investment in the network will prevent future investment in the network. If the level of overinvestment in the network was such that it prevented consumers from being able to fund, through their electricity bills, future investment then this could have a huge consequential impact on the way that the network evolves. We agree with Ofgem's assertion that there needed to be additional controls in place for network investment and we believe that this would limit the extent of the risk of overinvestment.

We believe that competition and innovation had the potential to bring significant benefits to a wide range of consumers over the course of the next price control period, and beyond, and overinvestment in the network will have the effect of suppressing innovative solutions and competitive pressures. There needs to be a balance struck between the level of investment and the way which that investment is deployed into the network. Over investment in the network is likely to set the path in a much more rigid way and will reduce the flexibility to cater to future network users' needs, which cannot be accurately forecast at this time..

Q13. What are the benefits and risks to deliverability if network reinforcement is deferred to future periods?

There are some benefits to deliverability of deferring network reinforcement insofar as it allows time for supply chains to develop, customer needs to be better understood and more

appropriate solutions to be deployed. It is also possible that other solutions which can act as an enduring way of avoiding reinforcement (such as energy efficiency or local generation) will materialise in the time period for which reinforcement is able to be deferred and so would negate the need to delivering network reinforcement in its entirety.

One of the potential risks to the deliverability or reinforcement if it is deferred is that it is impossible to accurately predict future reinforcement work which will be required, and deferring work now may risk imposing a unachievable future burden on network companies where more parts of their networks require reinforcement simultaneously.

The path to net-zero is not unlikely to be linear and will be driven by consumer requirement but will also be driven by the cyclic nature of the UK economy. Whilst deferring reinforcement may risk deliverability if the time period of its deferral coincides with other reinforcement, it is possible that deferring reinforcement may be able to flatten the lumpy nature of the scheduling of reinforcement works to make achieving all the necessary reinforcement more manageable.

Q20. Is a 5-year price control (2028-33) the right duration to achieve the objective of securing timely network capacity for the net zero transition at least cost to consumers over the long run?

Yes, this is the right duration during the net zero transition. It provides a good balance between certainty over a period of time but also isn't too long to be able to revisit decisions and reassess the efficient frontier of network operation. We believe that decisions need to be taken during this price control which will set in motion changes and work that spans over more than just this control, but we do not believe that this necessarily means that we need to move away from a five-year price control period.

Q21. To what extent should the price control be more directive on specific anticipatory and strategic investments to achieve the 'networks for net zero' consumer outcome?

Ofgem have always allowed DNOs the freedom to put in place anticipatory investment and reinforcement if it is demonstrated that to do so would be efficient. We cannot see a logical rationale behind changing away from this broad principle. Ofgem may wish to make changes such that DNOs are more likely to undertake such work, but we do not believe that this is a fundamental shift away from the status quo and it should not come at the expense of competitive solutions which can be deployed ahead of need.

Q23. Should the price control provide more guidance or guardrails around the use of particular network solutions to achieve the 'networks for net zero' consumer outcome?

Load related expenditure is likely to grow significantly over the period of the price control and we recognise the need to provide guidance to network operators of the use of particular network solutions to help achieve desired outcomes. Notwithstanding that point, we do view one of the critical considerations to be not to constrain innovation. Networks across the UK are built to differing standards and technical solutions so this needs to be taken into account when looking at potential solutions. The industry should look at the ways that a solution will improve a network and make use of trials and research around the world to ensure we are

bringing the best solutions to the UK networks. These solutions need to be shared but we understand the same solution will not work for every area or every consumer, it is not a one size fits all scenario.

Our answer to Q4 is also relevant to this question: Transparency and access to load forecasting data will be key to ensure that network investment is undertaken efficiently. Network operators will naturally have a bias towards installing more cables and plant, however, there needs to be a much wider use of Smarter whole system solutions.

Q24. Should we consider how we might bring all network capex investment together within the framework, irrespective of driver (e.g. load, asset health, resilience), to ensure a common approach to future proofing and delivery?

We do not believe that bringing all network capital investment into a common approach is likely to be positive for consumers. It may lead to consistency and clarity of treatment of capex, but this consistency and clarity belies the complexity of drivers for each of the cost categories. We have earlier asserted that the RIIO-ED3 period still has significant uncertainty and we believe that each of the drivers for capex need to be considered in relation to their specific needs. We do believe that transparency of what is driving capex is a key principle which should underpin all driver categories.

Q36. What is the best approach towards incentivising services to major connections customers and how should the MCI be adapted for ED3?

The Major Connections Incentive's ODI-F needs to consider a wider range of issues than it has currently been designed for. It does not currently consider all aspects relating to the connection process. For example, the surveys only consider the quotation and connection stages but do not consider other aspects, including provision of land rights, cost assurance and design.

A holistic approach, considering all methods of interaction between the customer and the service provider would therefore be preferable. It could be more beneficial if incentives were to be used as a positive way of encouraging better/more consistent performance.

Currently, a DNO may adjudge that the penalty for failure to deliver on the MCI has a lower cost and reputational impact than that expenditure required to achieve the required survey score. This prevents DNOs from being incentivised to improve their performance.

As we have said in answers to previous questions, the outputs of the MCI or any replacement should not be used as a means to substitute competition in the provision of electricity connections. Incentives on the provision of connections should only be applied on non-contestable works, or areas where there is no prospect of competition developing.

Q38. In the context of greater electrification, is our current approach towards regulating reliability appropriate for ED3?

We do not necessarily see a need to shift away from the current focus on reliability. Whilst there is going to be a greater degree of electrification overall, this does not necessarily mean that there should be a shift within the approach during RIIO-ED3. We understand that greater electrification of heat and transport is going to place a higher reliance on electricity for a

greater number of people and that reliability of the network is crucial to ensuring good consumer outcomes and economic growth. However, we believe that the current approach for regulation reliability is adequate and likely to be effective in ensuring that electricity networks continue to be reliable for consumers.

Q46. Do you see any reason why we should not implement the proposed updates to financial resilience requirements that we set out in RII0-3 Sector Specific Methodology Decision – Finance Annex for ET, GT and GD?

We have engaged directly with Ofgem's review into the financial ring fence but would like to reiterate at this point that it is important that the outcome of the review are proportionate to the parties on which they are imposed, that they do not inhibit investment and growth and that the potential risk which they seek to remedy is well considered and understood. We are concerned that the review has already drawn conclusions without undertaking a proper impact assessment to customers of the cost which the changes would impose, including the ongoing risk to future investment.

Regarding financial ring fencing, it is important to set out the case for change to clarify that there are risks that are being mitigated, or issues which are being addressed by any changes to the ring fence.

It is imperative that Ofgem recognises the structure and financing of multi-utility organisations and the value that this provides to consumers. Ofgem's financial ring refencing proposals as written would undermine the group financing arrangements and could unduly restrict the operation of BUUK's businesses, without providing additional protection to customers.

In proposing changes to the financial ring fence, Ofgem needs to consider the finance ability of licensees in the context of the global investment market. We have deep concerns that Ofgem's proposals would cause tremors with investors which would reduce the appetite of global organisations to invest in the UK utilities sector.

Q62. What specific issues are network companies facing in relation to the skills and capacity of their workforce and what measures should we take through the regulatory framework to mitigate these issues?

The lack of skills directly affects both new connection delivery, and operational aspects for both new and existing networks. This can impact in a variety of ways from delays to connection and reinforcement work, which consequently has a cost implication, to operations and maintenance on existing networks. A lack of skills also impacts the manufacturing, and understanding of the equipment used on the networks, both historic and current.

Ofgem could address the workforce and skills gap within network companies through specific allowances for development and training of staff. It is imperative that organisations have sufficiently skilled workforces to undertake the scale of required work, and we think that it is possible that there could be incentives placed on network companies to adopt meaningfully workforce planning strategies.

We would suggest that in the long term there is also a need for conversations with government to ensure that emphasis is placed on education and encouragement into STEM subjects for school age learners and mature students. Planning to meet the skills shortage in manufacturing and development of electrical plant, new innovation and other essential

components required to facilitate greater electrification is likely to be beyond the purview of Ofgem but it is important, in delivering a price control settlement that Ofgem signals to government that there is a need for more skilled workers across a range of jobs to support the industry.

There also needs to be some practical and pragmatic considerations on how the industry can help itself in delivering the necessary outcomes. One area that we think needs to be explored in greater detail is the ability of suitability accredited third parties, such as ICPS, IDNOs or other electrical contractors to undertake work on behalf of DNOs.