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Contact / Extension:
Scott Mathieson
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Dear Akshay,

RIIO-ED2 Open Letter Response (August 2019)

SP Energy Networks (SPEN) owns and operates the electricity distribution networks in the Central Belt and South of Scotland (SP Distribution) which serves 2 million customers, and Merseyside and North Wales (SP Manweb) which serves 1.5 million customers. We also own and maintain the electricity transmission network in the Central Belt and South of Scotland (SP Transmission).

We welcome the opportunity to respond to Ofgem's Open Letter Consultation on the approach to setting the next electricity distribution price control (RIIO-ED2). The open dialogue between Ofgem and the DNOs in the months preceding the publication of the open letter has been encouraging. We look forward to continuing to work with Ofgem in the development of a regulatory framework that is fit for the challenges we will face in ED2.

This is an unprecedented time for distribution networks. Not since privatisation has there been so much uncertainty, change and opportunity for our industry. We encourage Ofgem to be bold in its ambition for ED2, as energy networks will be pivotal in enabling society to achieve Net Zero¹. The decisions taken in the coming months and years will lay the foundations for achieving this. Clear direction and regulatory certainty from Ofgem must be a priority.

The consultation questions are wide and varied, and we have attached our detailed responses in the appendix to this letter. However, in this letter we wish to highlight key areas that should be at the forefront of Ofgem's mind as the ED2 price control negotiations progress. The right balance needs to be struck across these areas as we seek to reach a fair ED2 settlement. This will allow us to continue to invest in our network and communities; to continue to deliver a safe, resilient and environmentally sustainable network; and to continue to enhance the value-for-money services we provide to consumers.

Build on the successes of ED1

Since incentive-based price control models were first introduced, network companies have demonstrated positive outcomes for UK consumers. This includes a 17% real terms reduction in

¹ As recognised by Ofgem in the response to the CCC:

https://www.ofgem.gov.uk/system/files/docs/2019/08/letter_to_networks_on_achieving_net_zero.pdf

network prices²; 50% real terms increase in investment³; 30% reduction in the number and duration of power cuts⁴; consistent improvements in customer satisfaction scores, which exceed those of John Lewis and Amazon⁵; all whilst supporting economic growth with increased jobs and facilitating the decarbonisation of the UK. We must review the benefits delivered by network companies under RIIO-1 and consider how best to embed and build on them further.

SPEN has a strong track record in ED1. We are delivering superior customer service (currently the top DNO group for BMCS results 2019 YTD) and are forecasting to deliver all of our networks outputs and allowances. We have fully embraced the CNAIM approach to asset risk, embedded ISO55000 accreditation, and are developing a strong reputation as industry leaders in asset management. We provide accurate business plan submissions and deliver our investments.

SPEN is delivering on its ED1 business plan outputs and is not forecasting significant outperformance to allowances, unlike some DNOs. In line with the general approach to price controls adopted across the regulated sectors, we encourage Ofgem to continue to review output incentive targets in light of revealed performance in RIIO-1 and use the latest data for future targets for the benefit of consumers in RIIO-2. We would also encourage Ofgem to resist a 'one size fits all' approach to company returns, particularly where there are demonstrable differences across DNO groups.

In RIIO-1 to date, there has been considerable focus on ensuring "Fair Returns". Whilst we believe it is Ofgem's role to scrutinise company returns, the resulting actions must be within the framework of the price control settlement and balance the needs of consumers and investors. It is important that Ofgem upholds well established regulatory principles and does not overreact to external pressures.

As we move towards ED2, network companies are facing increasing uncertainty associated with the external political environment and the requirement for increased investment to facilitate Net Zero. If the UK is to attract the necessary investment in the energy system going forward, it is essential that investors view the regulatory framework as stable.

Reflect the ambitions of the communities we serve

The UK Government is committed to legislating for Net Zero emissions by 2050, and the Scottish Government's has already legislated to accelerate this target to 2045. At a more local level, cities and towns are aiming to reach these targets even sooner. For example, Liverpool is aiming for Net Zero by 2040⁶, while Edinburgh has set its Net Zero target as 2030⁷. Furthermore, we have already seen the Scottish Government set a target for all new vehicles to be low emission by 2032, versus a UK target of 2040. These timelines indicate that there is a need to quicken the pace of electrification for the UK and its regions to achieve Net Zero, and Ofgem needs to be agile and pragmatic in its response.

SPEN, as the only DNO group to operate across all three UK political administrations, must incorporate these differing views and policy objectives within our ED2 business plan submission. If the UK is serious about decarbonisation, there is also the need for much greater input from devolved and local governments in regulatory decision making.

It is essential that Ofgem recognises that our devolved governments have differing low carbon ambitions, acknowledging the distinct underlying characteristics and challenges, which may mean that tailored solutions are appropriate for different geographic areas. If the next set of price controls does not

² <https://www.ofgem.gov.uk/news-blog/our-blog/why-cost-capital-networks-likely-fall>

³ Ofgem (2008), SGBI speech

⁴ <https://www.ofgem.gov.uk/ofgem-publications/76425/rpix20-press-release-finalpdf>

⁵ Ofgem (2017), 'RIIO ED1 Annual report 2015/16' and Ofgem (2015), 'Electricity Distribution Company 2010-2015'

⁶ <https://www.liverpoolcityregion-ca.gov.uk/combined-authority-sets-ambitious-targets-to-tackle-climate-emergency/>

⁷ <https://www.bbc.co.uk/news/uk-scotland-48269986>

incorporate this, then there is a real risk to our communities and stakeholders that we will not be able to help them deliver their low carbon ambitions.

Enable the investment required for Net Zero

There has been much debate around the role of anticipatory/strategic investment for low carbon solutions, such as Electric Vehicles. The future is uncertain, so there is a reluctance to invest ahead of need. On the other hand, if we don't invest in our infrastructure now, there will be significant opportunity costs if we strangle the pace required to meet Net Zero. Ofgem Chairman Martin Cave recently recognised this as the “chicken and egg dilemma”⁸.

As acknowledged by the Committee on Climate Change⁹, upgrades to our networks can take up to 10 years to deliver. Furthermore, the Scottish Government's recently published ‘electricity and gas networks: vision to 2030’¹⁰ recognises that substantial investment in new capacity for our electricity networks is required. Therefore anticipatory investment is critical to support the uptake of the low carbon technologies essential to Net Zero delivery.

There is a risk that too much complexity in the price control framework for anticipatory investment could dampen the pace of investment needed. Ofgem needs to develop a framework which firmly establishes anticipatory investment as an effective tool within ED2. To enable this, a clear and transparent methodology should be used, such that the costs and drivers are clear, but which fully takes into account the wider societal benefits of Net Zero delivery.

The high degree of uncertainty must also be addressed explicitly as it will not be possible to set accurate ex-ante allowances in the above context. The use of revenue drivers for areas including LCTs, distributed generation, and flexibility, should be considered as an alternative where impact cannot be assessed upfront. A successful precedent is the DG Incentive Mechanism deployed in DPCR5. This style of approach could be used in combination with ex-ante allowance for areas which have greater certainty of costs, e.g. conventional solutions.

Harness this unique opportunity to deliver the benefits of Low Carbon Technologies

The open letter states that consumers should expect to be served by a local network that ‘*supports the target of net-zero carbon emissions for 2050 by enabling the rapid roll-out of low carbon technologies, including electric vehicles, and the development of a charging network to support them*’. We share this vision, and are keen to work with Ofgem to ensure that DNOs are enablers to the low carbon transition and that Ofgem is not unfairly viewed as the ‘blocker’, should we be unable to meet our consumers’ demands.

The National Infrastructure Committee has recognised that ‘*Ofgem and local authorities should enable the roll out of a truly national, visible charging infrastructure for electric vehicles, sufficient to encourage consumer demand to reach c.100% of new electric car and van sales by 2030*’.¹¹ Michael Matheson MSP – Cabinet Secretary for Transport, Infrastructure and Connectivity in the Scottish Government – recently wrote to Ofgem stating that ‘*It is important that investment in electricity networks is coordinated with the growth and development of EV charging ... our aim will be to ensure that the infrastructure keeps pace*’.

In order to make this a viable goal and cost effective to consumers, it is our view that DNOs must have the principal oversight and planning role in any EV charging roll out, working alongside Ofgem and key stakeholders (such as regional and local governments). We must learn from the mistakes made with

⁸ <https://www.ofgem.gov.uk/publications-and-updates/martin-caves-speech-state-market-event-2019>

⁹ https://www.nic.org.uk/wp-content/uploads/CCS001_CCS0618917350-001_NIC-NIA_Accessible.pdf

¹⁰ <https://www.gov.scot/publications/vision-scotlands-electricity-gas-networks-2030/>

¹¹ https://www.nic.org.uk/wp-content/uploads/CCS001_CCS0618917350-001_NIC-NIA_Accessible.pdf

GB's smart meter roll out, where suppliers held this responsibility, yet every other EU nation chose to do so through their DNOs, which has proven to be more successful.

We believe that DNOs are best placed to roll out GB charging points. In conjunction with stakeholders, DNOs can ensure that provision of access is targeted on an equitable and technically achievable basis; that costs would be efficient due to our delivery experience and expert network knowledge; and that asset stewardship would be at the forefront, ensuring the safe installation, operation and maintenance of electrical infrastructure. We intend to demonstrate these inherent advantages during ED1 via our recently announced, joint-funded project between SPEN, SSE and the Scottish Government, which will focus on innovative ways to deliver EV charging infrastructure.

We would encourage Ofgem to clarify the role of DNOs in the EV charger roll-out. Furthermore, the ED2 process should seek to formalise the ability of DNOs to own, develop, manage and operate EV charging infrastructure where the market has failed to deliver. This would align with the provisions of the EU Electricity Directive.

Ensure that no customer is left behind in the low carbon transition

Customers are at the heart of our business. The transition to a low carbon economy, with its greater dependency on electricity infrastructure, will create both opportunities and risks for our customers.

We believe DNOs have a role to play in helping customers through the energy transition to access new markets through education, collaboration and partnership to ensure disadvantaged customers are not left behind. We understand that some customers will be more dependent on electricity and that we have a role in supporting them to avoid fuel poverty. It is our intention to understand in detail what support each of our vulnerable customer groups would need to access new services and technologies. It is possible that this could be delivered through an extension to the vulnerability incentive, with DNOs measured on their effectiveness in supporting customers through this new landscape, through partnership, collaboration and innovation.

It would also be prudent to learn lessons from the deployment of past initiatives that were designed to support vulnerable communities but had limited success, e.g. Green Deal. Engagement with key stakeholders such as Citizens Advice Bureau may be prudent to ensure the practicalities of such schemes are understood.

DNOs, Ofgem and Government also have a part to play in bridging the divide between those knowledgeable about new markets and with the funds to access them, and those with less knowledge or an inability to access new markets and services. We must ensure that the ED2 framework does not strand or penalise customers in the low carbon transition, particularly the most vulnerable, who may have the least ability to engage with, and benefit from, new markets and services.

Focus on the DSO transition to deliver early competition

In 2016, we issued our DSO Vision as we recognised that the evolution towards a smarter, more sustainable, low carbon energy system will only be possible if DNOs play an active coordinating role in developing and facilitating new energy markets. DNOs already have the communications infrastructure, control centres, and deep knowledge of distribution network operation. It would be a small step for the DNO to take on this role of neutral market facilitator.

We are already delivering significant progress in this area, having developed design tools to quickly identify reinforcement projects where flexibility is likely to be a viable alternative. This resulted in an initial tender in March this year for 116MVA of flexibility services across three different areas. Following this, we will also shortly be tendering for up to 110MVA of flexibility services across England, Scotland and Wales, with contract lengths ranging from 1-4 years. As part of this, we believe that we will be the first DNO to tender specifically for reactive power services (MVAR) to help with voltage constraints.

Moving forward, we are firmly of the view that early competition processes in ED2 should be delivered by DNOs through the DSO model. The DSO model offers significant advantages in the delivery of early competition, such that if new solutions are required, the DSO can adopt these at the earliest opportunity, delivering the most cost effective outcome for consumers and the network.

For early competition, 'certainty of system need' must be considered to ensure the delivery of real benefits to consumers. DNOs are best placed to identify where alternatives to traditional infrastructure reinforcement are the least-cost solution to a particular network problem, using their technical proficiency and intricate knowledge of their own networks and local/regional circumstances.

Acknowledge the benefits of flexibility alongside the role of traditional and smart solutions

Network utilisation, capacity and functionality must increase if we are to facilitate the decarbonisation of transport and heat, alongside the decentralisation of generation. To ensure that the network can cope with these increased demands, the use of flexibility must be balanced with other traditional and smart network solutions.

We believe that we are at the forefront of promoting and developing flexibility, and that we should be seeking to use flexibility where it is the best value solution for current and future consumers. To do so, it is essential to understand the true value of flexibility, and therefore important to be transparent about how that value is calculated. This is especially relevant to our responsibility to protect vulnerable and fuel poor customers, who may be the least likely to participate in, and benefit from, flexibility markets.

Decarbonisation and decentralisation will place a greater reliance on our underlying asset base; continued safety, resilience and security will be ever more vital. This comes at a time when changes in demand and utilisation will place greater strain on assets of deteriorating condition and increasing age. The criticality and risk of our network assets will be greater than ever before.

With a current asset turnover of between 1.5% and 2%, it would take upward of 50 years to replace the entire asset base. While flexibility will defer or avoid some of this investment, increased network monitoring, automation and smart solutions, combined with necessary conventional investments, will be required to ensure that DNOs can continue to provide exceptional safety, reliability and security in these increasingly demanding circumstances.

Changes in demand and utilisation of our asset base may also impact some areas of our network more acutely, and more quickly, than others. Specifically, we believe that the local LV networks, many of which were installed mid-20th century, may be the first to experience significant impacts, through the onset of wide scale uptake of EVs and electric heating. This will likely require an enhanced, proactive approach to safety and security of supply on the LV network in ED2, through both traditional and innovative means.

Next steps

We look forward to a constructive and open dialogue throughout the ED2 price control negotiations as we seek to reach a fair settlement. If you would like to discuss anything in further detail, please do not hesitate to contact me.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'Scott Mathieson', with a long horizontal flourish extending to the right.

Scott Mathieson
Network Planning & Regulation Director
SP Energy Networks