25 September 2020

Dear Akshay, Steve and Colleagues

Ofgem's RIIO-ED2 Methodology Consultation

Sustainability First is an independent think tank and charity focused on promoting economic, social and environmental wellbeing in public utilities.

We welcome the opportunity to comment on the draft ED2 sector specific methodology. Our comments draw on our experience as members of Ofgem's RIIO-2 Challenge Group, the position of two of our Associates as chairs of Consumer Engagement Groups (and as members of others) plus our active participation in a number of the Ofgem RIIO-2 stakeholder working groups. We also draw on 20 years of deep expertise in consumer issues (engagement, vulnerability, data, behaviour change etc), environment issues (decarbonisation, net-zero, adaptation), policy and regulation (innovation, price controls, incentive frameworks etc), plus business leadership and practice for utilities.

Sustainability First is pleased to see how Ofgem's thinking has evolved with a number of important developments compared to the methodology for transmission (electricity, gas) and gas distribution. This includes a **new ED2 approach to financial ODIs linked to strategies in key areas, plus some proposed new mechanisms for dealing with uncertainty**. As well as an understandable focus on cost-efficiency, the ED2 methodology covers a large number of topics. This letter sets out a summary of key areas where we believe **from a wider sustainability standpoint more thought is needed by Ofgem.** We attach in an annex answers to the consultation questions where we have a particular contribution to make. Our submission urges Ofgem to :

1. Consider **the overall package in-the-round** on whether it delivers the step-up needed for ED2, especially for decarbonisation and net-zero;
2. Provide **a stronger financial incentive around a net-zero and de-carbonisation strategy** using the 'strategy delivery incentive' model adopted for other areas;
3. Significantly strengthen the focus on **actions to deliver short- to medium-term decarbonisation** (business carbon footprint – especially losses, SF6);
4. Broaden **the toolkit used to deal with uncertainty** as part of the welcome shift to adaptive regulation for new net-zero network investment;
5. Consider **the role of local engagement, forecasts, the D-FES and local area energy plans** in addressing uncertainty and shaping company business plans;
6. Consider how to make **reputational incentives more effective**; and
7. Provide some additional clarity on the scope of support that is expected around **vulnerability, local needs and no-one left behind** as part of the welcome inclusion of the requirement for a strategy with a financial ODI.

1. The overall ED2 package in-the-round

The ED2 draft methodology sets out the detail of how the distribution networks must frame their business plans, and critically, is the basis by which £billions of investment will be decided. **There is wide agreement that the methodology needs to drive a 'step-up' from the current ED1 baseline to make true progress on decarbonisation and net-zero in the ED2 period.**

Furthermore, for ED2, new complex and cross-cutting distribution activities must be correctly incentivised, integrated, consolidated, measured and monitored. This includes the DSO role and approaches to customer flexibility, company digital strategies, alignment of ED2 network investment plans with the forthcoming 6th carbon budget, support for the net-zero ambitions of devolved, regional and local government – plus ongoing deep reform of network charging. Ofgem is also rightly seeking to 'bank' performance improvements from ED1 in new minimum standards – and at the same time continue to press for improved customer outcomes - be these for customers in vulnerable circumstances, for large connection customers, or more broadly. And across all these areas there is an expectation that company business plans will be informed by enhanced engagement.

The three main output categories for ED2 are consumer service, resilience and environmentally sustainable networks (as for T/GD). But against these objectives, and Ofgem's commitment to net-zero at lowest cost to customers, there are still some **critical questions of balance** which the final ED2 methodology must answer and which involve considering the package of proposals in-the-round as Sustainability First has flagged several times at the ED2 Over-arching Working Group. These questions include:

- **Step-up versus incrementalism** : how far do the proposed ED2 incentives, especially for decarbonisation and net-zero, drive a genuine 'step-up' – rather than incrementalism from ED1 ?
- **Balance of benefit between current consumers and future consumers** : on what basis will Ofgem judge this ?
- **Role of Business Plan Incentive and Consumer Value Proposition** : how to successfully adapt the T/GD BPI in ED2 so that the CVP becomes a far more effective driver of ambition and facilitates cross-company benchmarking by stakeholders ?
- **Incentive design - financial vs reputational** : how far might better outcomes be delivered in ED2 if more use is made of financial incentives - in particular on de-carbonisation and net-zero ?
- **New net-zero investment** : how to balance regulatory caution on network redundancy and stranding against loss of strategic or societal benefit (optionality, resilience, carbon) ?
- **Network support for the net-zero commitments of elected authorities** (devolved, regional, local government) : what process and level of evidence does Ofgem require for the networks to support locally-driven network projects (eg on EV charging infrastructure) ?
- **Role of stakeholder engagement in shaping Ofgem decisions** : in ED2, what weight will Ofgem give to stakeholder inputs on complex trade-offs (e.g. on affordability today vs the needs of 'future society') ? How will Ofgem balance the need for local priorities to shape plans against the wish for nationally consistent approaches ?

For the ED2 price control to become a true game-changer for the distribution networks, Ofgem needs to clarify and communicate its own thinking on these fundamental questions of balance in its final methodology.

2. A stronger financial incentive around net-zero and de-carbonisation

The draft ED2 methodology introduces a new environmental framework for the companies with a clearer expectation than for ED1 on **common methodologies and more consistent environmental reporting against long-run targets**. Over time, the requirement for an Environmental Action Plan (EAP) plus clearer annual reporting (via the Annual Environmental Reports [AERs]) will allow the companies, the ENA, Ofgem and wider stakeholders to build a better-informed and more accurate environmental picture – including cross-sector and cross-vector. This is very welcome. Ensuring this is accessible to interested stakeholders will clearly be important.

However, **across key environmental outcomes**, the draft ED2 methodology proposes **only relatively weak reputational output incentives** (for AER reporting, for losses, for SF6 leakage). In some instances, these incentives are actually weaker than in ED1. **We question how far the proposed set of reputational incentives will successfully deliver an environmentally sustainable network**.
By contrast, for some other key ED2 areas (DSO, large connections and vulnerability) a **new mechanism – a 'strategy delivery incentive' -** is proposed that requires the companies **to develop strategies and then deliver against them**. This is welcome. These SDIs require companies to **meet Ofgem minimum requirements but also crucially include a financial incentive to ensure that the companies deliver against their strategies and are motivated to go further.** These strategy delivery incentives will be assessed mid-period by Ofgem plus at the end of the price control, taking account of performance against pre-defined metrics but not purely mechanistically. **This seems to provide an appropriate balance of a quantitative and qualitative incentive in what are complex areas.** We should like to see an equivalent **'strategy delivery incentive' to drive environmental progress, in particular for decarbonisation and net-zero – and we would urge Ofgem to consider this.** This strategy approach would bring together a cross-cutting incentive mix : clear minimum standards, a mechanism to ensure companies deliver on commitments, financial incentives with some metrics to stretch performance, plus reputational incentives where environmental outputs are not yet readily measured or assessed. **A strategy delivery incentive for an environmentally sustainable network would allow Ofgem to send a stronger and more concerted signal to the companies on the value of decarbonisation and net-zero to current and future consumers**.

The draft ED2 methodology indicates that Ofgem is open to evidence on how financial incentives for environmental outputs could drive additional value for consumers in a manner which is measurable and does not create perverse incentives on companies. We note that for NGGT and NGET Ofgem is proposing to accept a financial incentive based on a scorecard of EAP metrics. In its decision Ofgem said "*we consider that an ODI-F would ensure NGET has a financial interest, proportionate with its involvement and effort, in achieving or exceeding the RIIO-2 targets set out in its EAP*". This summarises well the rationale for a financial incentive in this area. Ofgem has put careful thought into the design of the NGGT/NGET incentive to weight the different metrics appropriately. While this EAP scorecard feels to us less flexible than an in-the-round 'strategy delivery incentive' approach, it demonstrates that quantification is possible and may provide a useful starting point for developing a broader strategy delivery incentive.

We note the proposed split in scope of the EAP between **'decarbonise the networks'**[1] and **'reduce the wider environmental impact of network activity'**[2], which is a helpful distinction. We also note that the proposed baseline standards for each area reflect rather mixed ambition-levels which continue to be debated in Ofgem's ED2 Decarbonisation and Environment Working Group[3]. Since initial design of ED1 incentives over six years ago now, new net-zero requirements fundamentally change the picture. We have a real practical concern that Ofgem's approach in ED2 to the environmental baseline standards for decarbonisation **is largely incremental rather than a 'step-up'.**

Company commitments – made via EAPs – will be reflected in business plan base-line funding bids. Stronger environmental ambitions should be reflected in good outcomes for companies from the consumer value proposition in the business plan incentive.

However, progress on those commitments during the price control period - reported via AERs - will **depend for delivery largely on a reputational incentive** - **unless treated as PCDs**[4]. If faced with a tight price control, companies will look to make savings where they can. While many have a strong corporate commitment to a sustainability agenda, this may come under pressure should investors face lower returns. We can already see this in water. **A reliance on reputational incentives alone is therefore not adequate for this critical area.** While PCDs may help on non-delivery, on their own they do not provide a sufficient incentive on companies to continue to look for opportunities **to go further in the price control period - which a financial incentive as part of a strategic delivery incentive would do.**

3. Actions to deliver short- to medium-term decarbonisation

As well as the need for financial incentives for delivery of environmental outputs, we continue to have significant concerns about the overall **ambition-level of the draft ED2 methodology on short- to medium-term decarbonisation**.

On **business carbon footprint** and the EAP, **Ofgem's position on science-based targets needs to be clarified**. Ofgem indicates that companies should sign up to these - described as targets that are consistent with the Paris agreement[5] and net zero obligations in the long-term[6]. In practice, the science has continued to develop since the Paris agreement in 2015 and the leading organisation in this area now encourages companies[7] to sign up to targets that are consistent with a 1.5 degree

[1] Decarbonise the networks : BCF, Losses, SF6, Embodied carbon (Annex 1. Table 41. P 141. Proposed Scope of the EAP)
[2] Reduce the wider environmental impact of network activity **:** supply chain management, resource use and waste, bio-diversity & natural capital, fluid filled cables, noise, NOX & air quality
[3] Annex 1. Table 42 para 9.16, p 143 & Appendix 8 (p 189)..
[4] Price-Control Deliverables – and which in general they were not in the T/GD draft determinations on materiality grounds
[5] Annex 1. Footnote 117. P 143
[6] Annex 1. Para 9.12. p 142
[7] https://sciencebasedtargets.org/step-by-step-guide/

temperature increase. Importantly for ED2 this is also consistent with the UK's 2050 statutory position on net zero. Ofgem should therefore recognise this and **clarify that DNOs should adopt science-based targets which align with 1.5 degrees for their own emissions**. Although perhaps implicit, there would also be merit in making clear that the definitions on the scope of the emissions to be included in these targets should be consistent with the global Greenhouse Gas Protocol and the science-based targets initiative. To tie in with Ofgem approaches to BCF and EAP incentivisation, it will be important that distribution losses continue to be classified as scope 2.

On **distribution losses**, we recognise that losses are a complex area but are very concerned that Ofgem seem to be going backwards compared to ED1.

We do not agree that losses should be incentivised only by a reputational incentive. As outlined in section 2 above, a decarbonisation strategy delivery incentive is needed which incorporates a financial incentive, including for losses.

The ENA has overseen a review of losses treatment[8] – and has put forward a proposal for a losses reputational incentive with life-cycle CBA, which Ofgem seems inclined to adopt (albeit how CBA outcomes on losses will be factored into investment plans is still being discussed). However we do not consider that this approach of itself provides a strong enough incentive on companies to address losses. The use of CBA in developing investment proposals for the business-case makes sense but there needs to be a clear mechanism to ensure that companies do not ultimately decide to make efficiency savings by installing cheaper higher-loss equipment. To date, incentive design on losses has been largely company-led. We would simply note that the interests of companies and consumers in the area of losses may not necessarily fully align.

In its recent decision on Tranche 3 of the Losses Discretionary Reward Ofgem highlighted the importance of tackling losses. It is therefore worth noting that Ofgem concluded (and likewise for Tranche 2) that none of the companies were doing enough in this space to merit a reward (despite £14 million being available). In this context it is hard to see how a purely reputational incentive can be expected to deliver an adequate response by the companies[9].

In the absence of any meaningful alternative we therefore strongly disagree with Ofgem's proposal to drop the ED1 Losses Discretionary Reward (which Ofgem describe as a reputational incentive – but has a clear financial dimension).

In the long term – once the grid is fully decarbonised – the association of losses with carbon emissions will cease. However, at around 95% today of all DNO Scope 2 emissions reported to Ofgem, losses will remain the dominant source of carbon emissions associated with DNO operations in ED2. And for the long-term, losses will also remain a very significant efficiency issue. Currently,

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[8] WSP report for ENA. September 2019
CEP023 Technical Losses Mechanism Study. Development of a Losses Incentive Mechanism: Phase 1 Final Report.
https://www.energynetworks.org/assets/files/CEP023%20Technical%20Losses%20Mechanism%20Study%20Final%20Report.pdf
[9] 14 September 2020
https://www.ofgem.gov.uk/system/files/docs/2020/09/ldr_t3_decision_2020_final_0.pdf

losses account for ~6% (average) of energy transported by the distribution networks[10]. The ENA report suggests that losses from all energy generated could increase by 350% with the rise in LCTs. Meeting the electricity capacity requirements for electrification of heat and transport will be all the more challenging and expensive if such a significant proportion of the renewable energy generated continues in the future to be lost.

Losses will increase with new network investment, more renewables and also operating networks nearer their physical limits. Ofgem has said it does not want to favour one output over another. However the ED2 proposals risk doing just that by putting a financial incentive on connection of LCTs – while at the same time not on loss reduction. The networks need to be incentivised to balance these considerations appropriately throughout the price control period. While Ofgem has signalled that it will allow the costs of low-loss equipment in baseline allowances (where the case is made), as it stands there is nothing to stop companies ultimately opting for cheaper equipment in a quest for efficiency savings. The **merit of the Losses Discretionary Reward (or an updated version – as part of a new decarbonisation strategy delivery incentive as proposed above)** is that this would provide the flexibility to cope with the complexity inherent in losses while retaining a focus on losses through a strong (i.e. financial) output incentive for the companies to identify controllable losses and do more to manage them.

More focus also needs to be put on the **measurement of losses**. Historically, that may have been challenging but with the advent of smart meters and other monitoring equipment it should be possible to do a much better job. Improved measurement is one element of the Losses Discretionary Reward but is not addressed in the ENA proposals.

On **SF6** while we recognise that leakage is much greater on transmission, this remains a highly potent greenhouse gas with a global warming potential ~23,000 times that of CO2. **Having developed a financial incentive for SF6 leakage for ET we would expect the same incentive to be applied in ED to SF6 leakage** – the value of savings in SF6 emissions from either sector should in principle be the same. For distribution, planning for SF6 containment and eventual safe disposal should be a priority. In distribution, SF6 is spread in far smaller volumes but across a great many more individual items of equipment. Unless there is a real risk of leakage, to accelerate replacement before the end of asset-life would be costly and arguably of low consumer and emissions benefit[11]. As a minimum however there should be an **expectation on DNOs to work collaboratively**, **including with transmission companies and the supply chain**, to develop **a network-wide strategy and a plan into the RIIO3 period for safely reducing SF6 holdings over the long-run.** This should then form part of whatever wider financial incentive is put in place for environmental performance.

We also note that in terms of **the cost of carbon** there is a **consistency issue** on what Ofgem expects companies to use **for their investment appraisals** - and hence inform their decisions on losses or SF6. To date, the guidance to companies has been to use HMT assumptions. However, Ofgem's own IA guidance talks about carrying out sensitivity assessments at the high-end of the HMT range. This is

[10] Supplementary Data File
https://www.ofgem.gov.uk/publications-and-updates/riio-1-electricity-distribution-annual-report-2018-19

[11] Albeit new environmental regulations on SF6 phase-out would change the picture

because HMT figures have not yet been updated for net zero. We ask Ofgem to ensure that the cost of carbon figure which the DNOs are expected to use in their cost-assessments is transparent and consistent with net-zero.

Last, **the DSO role and remit** and how this is to be incentivised will be absolutely central to successful long-run company approaches and outcomes for emissions reduction and net-zero. Many others have a strong interest in the DSO role, and we do not propose to comment in detail here. However, we have a particular concern that **the draft ED2 methodology is silent on the DSO role in terms of approaches to both near-term decarbonisation and also to net-zero**[12]. In the DSO principles, the sole reference to carbon relates to providing information, inter al, on the carbon content of plant despatched for ancillary services. There seems to be a very strong case for **the DSO to have a specific duty on decarbonisation and net-zero right across its role**. I.e in consideration of network investment decisions and alternatives, connections, operations, despatch and market development. With greater separation of DSO/DNO roles, an increasingly important question for Ofgem will be how to achieve an integrated approach to decarbonisation and net-zero across a DNO geography (e.g on losses management, SF6). This DSO duty would sit well as a part of our proposed 'strategy delivery incentive' approach to incentivising DNO decarbonisation and net-zero.

4. Adaptive regulation / strategic investment in ED2

We are pleased to see Ofgem's emphasis in ED2 on strategic investment and for the proposed new mechanisms to cope with uncertainty on the pathways to net zero. However, as Ofgem acknowledge there is clearly more work to be done and we hope that Ofgem will continue its programme of active engagement throughout the SSM consultation period to help take forward this detailed thinking. For ED2, we would wish to see an approach to uncertainty mechanisms **that can deliver robust outcomes which are both strategic and sufficiently devolved**.

In our response on the draft determinations[13], while supporting the reasons Ofgem had sought to move to a more adaptive approach to regulation, we raised questions about Ofgem's ability to make timely decisions - and with the necessary transparency and engagement - with extensive use of discretionary mechanisms (re-openers). **We therefore support Ofgem's efforts for ED2 to develop more mechanistic processes** (i.e such as volume drivers, plus the new concept of a Price Control

[12] Appendix 5 of the draft ED2 methodology - DSO roles and principles (pages 97-106) – no reference across discussion of the three proposed 'roles' and the five 'principles for baseline standards'. Principle 3.1 : Market development. Provide accurate, user-friendly and comprehensive market information. Baseline expectations. P.103 – on 'historic and future DSO ancillary service market actions', to include tender results, prices bid and paid, **the carbon content of aggregated units**, how often DER is despatched (and volumes) and other actions taken by the DNO (with anonymization of DER as required), including curtailment as part of non-firm connection agreements.

[13] Sustainability First. September 2020.
Ofgem, RIIO2, Draft Determinations for Gas and Electricity Transmission (T2), Gas Distribution (GD2) and Electricity System Operator (ESO) RIIO2 price controls
https://www.sustainabilityfirst.org.uk/images/publications/consultations/Sustainability_First_RIIO2_Draft_Determinations_Response_2.9.20_FINAL.pdf

Deliverable (PCD) with a funding trigger linked to regional plans). Mechanistic approaches seem particularly important for distribution where the individual project and network-level sums involved are smaller than transmission. We also recognise the need for the net-zero reopener in ED2 - but only where other uncertainty mechanisms will not work as intended[14].

Nonetheless, there are a number of elements for ED2 where more thought is required on strategic investment and the handling of uncertainty.

Getting forecasts 'right' is an impossible task. In its four models (A-D) for addressing uncertainty, Ofgem differentiates between **a centralised approach to setting forecast outputs** (with (A) more certain or (B) less certain - **against a decentralised approach to determining forecast outputs** (with more certainty (C) or less certainty (D). The key differences between these four models (which are not mutually exclusive) is whether local or national forecasts are used and whether volume drivers are applied. While this is a helpful way of framing the choices faced by Ofgem it is perhaps worth standing back and reflecting on the real underlying question. Arguably, in terms of revenue allowances it doesn't matter what the baseline assumptions are if there is an effective form of volume driver to adjust the allowances in line with the out-turn.

Rather, the main benefit in having a consistent national / common 'central' forecast is to aid Ofgem - plus other stakeholders - in benchmarking company business plans (which Ofgem have suggested is a separate issue). At the same time, given the importance of stakeholder 'buy-in' to the plans there seems to be a strong case for using locally developed forecasts provided that :

- It is clear how these relate to and align with national level policy plans and forecasts;
- There are clear criteria for the sort of evidence that needs to be put forward at a local level (see section 5 below).

There is no need to consider the question of 'central' and 'decentralised' forecasts in binary terms as there is a place for both. Timely engagement, iteration and transparency must however inform both **with companies potentially being asked to submit worked-up plans for both a common central scenario (for benchmarking) plus a local best view (to inform revenue allowances).** It is also clear that for core cost categories there is a high level of uncertainty - and hence the variants B and D which incorporate volume drivers seem to be the way forward.

Aside from Ofgem's four uncertainty models **there are a number of other areas where we believe Ofgem needs to do more work to ensure it has suitable tools in its toolkit to deal with an increasingly uncertain future and in thinking about strategic investment.** These include **:**

- Baseline headroom;
- Sequencing and business plan preparation ;
- Use of scenarios;
- Taking account of uncertainty in CBAs;
- Gaining a better understanding of temporal and locational variability;
- What success will look like by the end of ED2 and looking ahead to ED3.

[14] See our more detailed response on a net-zero reopener in OVQ3.

Baseline headroom:

Based on the T/GD draft determinations, it seems **important for the distribution companies to have some line-of-sight in the final ED2 SSM on the likely split between investment which might reasonably expect to sit within base-line revenues and the proportion of investment likely to be subject to uncertainty mechanisms triggered later in the price control period**. This links to our earlier point about the nature of investment at distribution voltages being different from transmission, with many more smaller individual projects. The relative initial split of revenues allocated to baseline allowances may therefore be justifiably different for distribution than transmission – in transmission there is uncertainty about the specific projects that will be needed whereas on distribution one can be more confident about the overall level of growth even if there is uncertainty about precisely when or where it will happen. **To make timely progress in ED2 towards net-zero, Ofgem needs to recognise the importance of at least some 'headroom' for DNOs to be sufficiently agile in facilitating and delivering many new connections** (including through non-network alternatives). DNOs must be in a position to respond in a timely way to the well-evidenced net-zero needs of others. If a high proportion of future connections-related investment ends up sitting outside baseline allowances – and / or enabled only via uncertainty mechanisms for later agreement (either through reopeners or with risks around how an automatic mechanism might work in practice) - then there is a danger that the DNOs could needlessly slow the legitimate net-zero ambitions and targets of others. There may also be a risk of DNOs developing and operating their networks in a needlessly inefficient or piecemeal way.

Sequencing issues and business plan preparation:

In considering how strategic investment is to be sufficiently funded in ED2 to make appropriate progress on net zero '*at least cost to customers'*, there are still some important outstanding **sequencing issues for Ofgem to address with respect to business plan preparation.**
First, **reform of distribution access charges** is a welcome and important step in facilitating connection of new distributed generators and new LCTs to progress net-zero delivery. However, some major outstanding questions remain, including on where the connection boundary for recovery of the costs of upstream distribution network reinforcement will be drawn in the future ('shallowish' or 'shallow'). This decision will impact the proportion of connection-related reinforcement costs that in future are to be borne by a connecting customer (or a group of customers) or by consumers in general. A provisional decision is first due only later this year, but will have a material impact on the volume and total cost of upstream network reinforcement (load-related capex) to be funded from company capital allowances[15]. Ofgem have suggested how this should be dealt with in Business Plans but there may also be implications for the SSM itself which raises additional timing concerns.

Second, **forecasts and scenarios (central / decentralised), the Distribution-FES and local area energy plans produced by local authorities** – **must all be informed by thorough and systematic stakeholder engagement**. Each has a major role in informing, shaping and demonstrating the realism and underlying evidence-base of ED2 business plans. Each is important in its own right and also in combination**.** Ofgem has yet to clarify their own expectation (albeit at a high-level) on how

[15] see our answer to question OVQ30 below

these different exercises might best be sequenced for effective *sector-wide* business plan preparation, including how different outputs 'sit together' across the whole system.

Third, on **incentivising business plan quality via the business plan incentive,** if one aim is to drive *wider ambition* across all of the companies as the basis for improved baseline standards, then we **agree that the CVPs should be assessed following the draft business plan submission[16].** At that point, Ofgem should also (1) **assess company overall approaches on engagement and produce a benchmarking report on the quality of company engagement** and (2) report on **the timeliness and quality of decentralised forecasts, scenarios and D-FES produced by the companies, including how far these deliver common and consistent approaches.** We agree that more focus should be given to the Consumer Value Proposition (CVP) element of the business plan incentive[17] . Following the mixed experience for T/GD we welcome this.

***Use of scenarios**:*

Ofgem's focus in the four models appears to be on trying to work out what to use as a 'central' forecast. But in the end, **it is at least as important to understand how the plans would flex within period to cope with different scenarios - including potentially more extreme shifts in demand**. **This is necessary for calibrating the ED2 volume drivers and incentives – as well as understanding the 'option value' that exists in certain investment decisions and where flexibility services play-in**. On scenarios, we would suggest that the companies be required to articulate in their plans how they would respond under different FES and D-FES scenarios. More broadly Ofgem should be looking for the companies to set out clearly how they would anticipate and respond to evidence of faster or slower progress in particular areas through the price control period. Improved monitoring may be one of the key steps to enabling companies to work out when and how to adapt their plans.

***Taking account of uncertainty in CBAs to support individual investment decisions**:*

Similarly, in terms of the approach to cost benefit analysis, further thought needs to be given as to how a more probabilistic approach could be developed. As set out by John Kay and Mervyn King in their book on Radical Uncertainty, uncertainty will always remain[18] and this means that a reliance on traditional cost benefit analysis and the quest for the optimal solution needs to be put in context. Having spare capacity on the network may be perceived as inefficient in a stable world but has potential resilience and carbon value in the face of uncertainty. For CBA assessments in an uncertain world, Ofgem may wish to consider how new CBA tools could be of use, including in assessing increased frequency of high-impact events[19].

At the ED2 over-arching working group Goran Strbac presented some thinking around alternative approaches to CBA to take account of uncertainty but this has not been reflected in the consultation.

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[16] 1 July 2021. Annex 2. para 13.29

[17] See our answers to COQ52-59 for more detail

[18] Net-zero is just one dimension of uncertainty that DNOs face. Uncertainties also include Covid-19, Brexit, 4IR etc which may influence the shape and level of demand, along with supply chains etc.

[19] E.g. CBA techniques capable of assessing more skewed distributions

"**Real options" theory** provides one way of thinking about these issues[20] – and illustrates how companies will want to take a more adaptive approach to how they manage their networks. The regulatory framework needs to more clearly enable that sort of approach. The Business Planning Guidance briefly mentions the use of (quasi) option values in CBAs but the references it points to are two Ofgem documents from 2012, one quite generic and one on gas interruptible contracts. This is an important area on which Ofgem should commission further thinking and guidance, specific to ED2.

One new and welcome suggestion from Ofgem which could help on uncertainty where project-level costs are significant are **PCDs with funding triggers linked to a regional plan** [21]. This has the benefit of being a mechanistic uncertainty mechanism that provides clarity and avoids the regulatory burden associated with a re-opener but is able to handle more lumpy investment than a traditional volume driver. More thought is needed from Ofgem on the actual nature of these triggers and the evidence required of the DNO in support. A probabilistic CBA approach could be used to inform the design of the trigger mechanism in some cases.

As noted, we would expect **volume drivers to have a particularly important role in ED2**. Mechanistic volume drivers can help manage uncertainty while still offering companies some forward line-of-sight to plan ahead. The challenge of identifying a suitable cost-driver is significant, given that costs will vary with location and local usage patterns. We also understand Ofgem's desire to link in some measure of utilisation to ensure there is consumer value from capacity added, although this adds further complexity and risks an undue focus on short term utilisation of what are long term assets[22]. We would encourage Ofgem to continue thinking on the detail of this through the Business Plan process and not to be deterred, recognising that even if there are some potential drawbacks with the proposed volume drivers it must still be better than the alternative of significant Ofgem and company time being required on re-openers and close out mechanisms creating delay and uncertainty. There will also be lessons in applying more mechanistic approaches in ED2 which will help inform future controls.

Another idea that Ofgem mentions in its consultation is the concept of '**touch the network once**'[23]. This is a helpful concept but cannot simply be applied mechanistically. **Ofgem needs to set out more clearly its own thinking on the criteria it might use to judge when this approach is appropriate**. It seems likely to be the right approach when, for example, sizing new transformers or cables, where the cost of repeated siteworks or streetworks may be very high and disruptive and the cost of a slightly larger transformer or cable relatively low. However, this approach probably would not make practical sense for IT-related investment requiring regular upgrades and where shorter asset-life would make under-utilisation more wasteful. Again, **a probabilistic CBA could be used to identify the kinds of use-case where a 'touch the network once' approach might be worthwhile in practice**.

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[20] See the report by Grid Edge Policy - here
[21] Overview. Appendix 3 on Uncertainty Mechanisms. Para A3.2 – A3.6
[22] There are also some important 'end of period' considerations to avoid creating a perverse incentive on companies to avoid investing in the final year of the control
[23] Para 4.41. Overview p 34

***Gaining a better understanding of locational and temporal variability**:*

One particular dimension of the uncertainty facing distribution networks is that the costs will be driven not just by the overall level of uptake of EVs for example but by the extent to which that demand is clustered street by street. This has implications for how volume drivers should be designed. Metrics such as average peak demand may cease to be so relevant if the peak period starts to vary more across the network reflecting different patterns of LCT-uptake and LCT-use by area and even by DNOs' own efforts to shift demand through flexibility services. These points came through in the PIAG[24] roundtable on regulatory uses of smart meter data that we hosted.
The DNOs are increasingly getting access to smart meter data which will allow them to understand these dynamics to better manage their networks, but will also enable them to exploit incentives that Ofgem puts in place if Ofgem does not have the same level of visibility and understanding of this more disaggregated data. It is unclear how much of an issue this will be in ED2 in terms of calibrating volume drivers but Ofgem should ensure that it is building its understanding of these factors to inform its assessments going forward.

***What will success look like by the end of ED2 - and looking ahead to ED3**:*

Finally, with the structural shift of lower baseline spend in ED2 to more funding for investment to be set via new adaptive approaches to regulation, it **is important to be clear what success will look like at the end of the ED2 period**. **Taken together the various uncertainty mechanisms will need to avoid the pitfall of piecemeal or unduly limited investment in the ED2 period.** Reassurance is needed that the 'strategic whole' adds up to more than the sum of its parts - not least to avoid a situation where customers are faced with an excessive bill for more costly catch-up in ED3 and the knock-on implications this may have for intergenerational equity. Having a sense of the longer-term trajectory with respect to the draft sixth carbon budget is also important in understanding how far the investment risks faced are simply questions of timing or whether there is a genuine risk of future stranding.

[24] Public Interest Advisory Group on access to smart meter data for a public interest purpose – a programme or work led by CSE / Sustainability First and supported by Ofgem. Report available here.

5. **The role of local engagement, forecasts, scenarios, the D-FES and local area energy plans** in addressing uncertainty and shaping company business

DNOs have a geographic footprint in need of recognition by Ofgem as a 'public good' in promoting successful ED2 outcomes. Notwithstanding initiatives in the ED1 period for development of company local area energy plans, D-FES development, heat-maps and geo-spatial energy-mapping trials[25], the draft ED2 methodology is relatively silent on how Ofgem sees the role of the devolved, regional and local authorities in their contribution towards delivery of UK net-zero targets – and in particular (other than the proposed PCD with a funding-trigger linked to regional plans) on how Ofgem may accord weight in the price control process to local authority strategies for net-zero. The Ofgem De-carbonisation Action Plan and Ofgem's NZAG terms of reference[26] signal the beginning of a shift to placing more weight on national, devolved and local government plans but with some significant caveats around potential cross-subsidies, in particular where democratic boundaries do not align with network areas (as will almost invariably be the case).

Faced with increased uncertainty, Ofgem recognise in the draft methodology that the case is stronger than ever for the companies to engage with local stakeholders who will be much closer to emerging issues and developments at a local level. In an uncertain world companies need a **diversity of views and strong antennae** to help navigate through. There is then a strong case for putting more decisions in the hands of those directly impacted rather than possibly unrealistically seeking to determine everything from the centre. On certain issues, local players can give advice on how to balance different interests and requirements in a fair way that can be difficult for remote players and is a key part of enabling a 'just transition'. Their involvement can also add legitimacy to the decision-making process.

For local authorities, having an understanding of what is expected by Ofgem is critical, if they are to successfully plan and budget. They need to understand on what basis Ofgem would in principle agree funding for local strategic network investment proposals submitted by companies as part of the price control process. **In particular, devolved, regional and local authorities must understand what detailed evidence they may need to provide in support of company business plans**, and subsequently with regard to a possible PCD with a funding trigger.

[25] SPEN Interactive Heat Maps (T&D) https://www.spenergynetworks.co.uk/pages/sp_distribution_heat_maps.aspx and AREMI utilities geo-spatial mapper- https://www.youtube.com/watch?v=MyZs0wxc0OI

[26] Ofgem Decarbonisation Action Plan. 3 Feb 2020. https://www.ofgem.gov.uk/system/files/docs/2020/02/ofg1190_decarbonisation_action_plan_revised.pdf Ofgem Net Zero Advisory Group ToR. 13 August 2020. https://www.ofgem.gov.uk/publications-and-updates/net-zero-advisory-group-terms-reference

***Developing de-centralised forecasts**:*

The need for stakeholders to be able to relate to and help shape the business plans is one reason why it is important in our view that business plans are informed by local forecasts and not simply a centrally-constructed case. Each DNO must produce a D-FES (tied into the national FES) and a Long-term Development Plan. They must also demonstrate a strong process on engagement to inform their own forecast outputs. Given the step-change expected in decentralised energy and LCTs since ED1, it is self-evident that decentralised approaches to determining forecast outputs must become a cornerstone of the ED2 methodology. At the same time, reliance on largely decentralised forecasts of outputs to determine ED2 allowed revenues brings new challenges for the companies, stakeholders, Ofgem and for others to establish well-assured business plans. **New common frameworks, processes and checks need to be developed by DNOs - and agreed with Ofgem - to demonstrate to Ofgem's satisfaction the robustness of the underlying evidence put forward in individual ED2 business plans - and then how these relate to national level forecasts on policy for example**. Demonstration of these processes and frameworks must under-write Ofgem and stakeholder confidence in DNO forecasts on volumes and expected timing of new renewable and LCT connections across their networks, and are likely to include :

- Demonstration of **a strong and systematic *process* across their full geography** to engage on, to inform and to test Decentralised Energy Resources (DER) & LCT forecast outputs for the ED2 period in line with net-zero expectations. This needs to include underlying growth assumptions for pandemic recovery.

- Adoption of **a framework and process common across all DNOs** - **as suggested by the Scottish Government in Ofgem's ED2 Over-Arching Working Group** – to enable devolved, regional, or local authorities with active net-zero commitments and / or who expect to go faster than 2050 – **to demonstrate to the satisfaction of the DNO** (and Ofgem) that their ambitions are potentially funded, achievable and robust, including realistic consideration of potential network options within ED2 time-frames[27]. This will be relevant to the PCD funding trigger linked to regional plans.

- **Information and support provided for connectees to make economic choices on DER & LCT connections** through heat-maps and similar initiatives (i.e to tie into the Large Connections Strategy Delivery incentive).

- Clear demonstration of how forecast outputs for DERs & LCTs are fed into ED2 business plan proposals **for non-network alternatives and / or for future optionality**.

[27] The draft Local Area Energy Plan best practice guidance from CSE and ESC is a helpful document. In the first instance, this aims to inform local authorities on how to develop robust energy plans to support them in their approaches to others, including to DNOs, Ofgem or government.

The check and balance role of centralised forecasts:

In practice, as we have noted a centralised approach to deciding forecast outputs for ED2 seems largely inappropriate. Top-down forecasts of likely regional development of renewables and LCT uptake will inevitably be relatively poorly informed. However, **indication of top-down expectation on some key assumptions and outputs for the ED2 period will offer basic benchmarks** – necessary to the companies, their stakeholders including the Consumer Engagement Groups (CEGs,) Ofgem and the Challenge Group **–** by which to question and in the end to understand and judge outliers in companies' individual decentralised forecast outputs. As a minimum, indication from Ofgem of top-down 'central' forecasts would be helpful on :

- HMT / OBR central forecasts on post-Covid annual economic growth to 2030 (national, regional);
- DfT and manufacturer forecasts on possible *pace* of EV uptake; and,
- Rate of expected heat electrification nationally and regionally - as informed by *current* government policy.

Both common and decentralised forecast outputs and scenarios from the companies are central to the success of the ED2 price control process overall, because these underpin much else**. The BPI incentive should therefore link clearly to both the timeliness and quality of company forecasts and scenarios.**

Stakeholder expectation on engagement:

Furthermore, with Ofgem emphasis on the need for **stakeholder engagement** by the companies then it is also vital for stakeholders to **understand how their input can affect the final outcome – and whether in practice their inputs have had an impact.** The draft determinations have been significantly disappointing in not drawing out how stakeholder views have shaped Ofgem's thinking. Of course, Ofgem cannot simply do whatever stakeholders say, but trying to provide **clarity around the level of detailed evidence required via local area energy plans will help**. Such clarity will also help avoid needless frustration from stakeholders, including local authorities, who may not have a detailed understanding of the price control process. **Making a commitment to close feedback loops and explain why and why not stakeholder views have been taken on board is crucial for the enhanced engagement process to be seen as valid and 'worth it.'**

We would also urge Ofgem to **worry less about questions of cost-socialisation across geographic boundaries**. In particular, where investments are being made to support particular cities or geographic areas as path-finders on net zero, then the benefits cannot be ascribed just to the inhabitants of that city but rather to the wider community – including the benefits of carbon reduction and the broader lessons such pioneer cities and metro-areas provide. While we are aware that an initial suggestion of caution came from the NIC in their Strategic Investment and Public Confidence report[28], this was in the context of encouraging Ofgem to move to take more account of input from devolved administrations and metro mayors than historically. There has always been significant cross-subsidy between different parts of the DNO network – rural versus urban for example. There is no reason to be unnecessarily concerned about this in the context of investment

[28] https://www.nic.org.uk/wp-content/uploads/NIC-Strategic-Investment-Public-Confidence-October-2019.pdf

to support net zero. **It is inevitable that democratic boundaries will not align neatly with DNO areas and this should not be used as a reason to not take account of these important regional voices.**

6. Reputational incentives

Another way in which stakeholders are expected to play a key role in RIIO-2 is through reputational incentives. It is clear that for RIIO-2 Ofgem is looking for these to play a more significant role given concerns about over-rewarding companies through financial incentives. However, as we set out in our response to the draft determinations for T/GD, if Ofgem is to rely on reputational regulation then it needs to consider seriously how to make that as effective as possible[29].

To supplement our response to both the DD and ED2 SSM consultations we have pulled together some initial thoughts on what we see as the key criteria for reputational regulation, based on an earlier UK Regulators Network (UKRN) report[30] on the subject and previous Sustainability First thinking. We would like to promote a wider discussion on these issues and would be happy to work with Ofgem to facilitate such a debate. We expect to take this forward as part of our Fair for the Future project.

Based on our initial thinking, **key themes** that Ofgem will need to address are:

1) Ensuring comparative data is readily accessible to enable benchmarking within / beyond a sector
   - Ensuring there are common definitions, baselines and consistent approaches
   - Providing assurance that data is reliable
   - Ensuring data is readily accessible
   - Proactive provision of ready comparisons to help lightly resourced stakeholders

2) Reflecting on the sources of reputational influence (and how best to strengthen them)
   - "Doing the right thing" where companies have a broader public purpose
   - Changes to Section 172 of the Companies Act and ESG as a growing concern among investors. These factors, and others, are driving changes in corporate reporting across the economy. Our recent Fair for the Future Project paper on Sustainability Metrics and Public Utilities examines these issues in more detail.[31]
   - Corporate reputation through eg media or select committees – noting also the role that social media can play in amplifying any reputational issues[32]
   - Company credibility and the implication for future regulatory decisions

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29 https://www.sustainabilityfirst.org.uk/images/publications/consultations/Sustainability_First_RIIO2_Draft_Determinations_Response_2.9.20_FINAL.pdf

30 https://www.ukrn.org.uk/wp-content/uploads/2018/06/2040728-DataPubRepReg.pdf

31 https://www.sustainabilityfirst.org.uk/images/publications/fair_for_the_future/25191_Sustainability_First_sustainability_metrics_report_v9.pdf

32 Discussed in a Fair for the Future working paper - here

3) Wider regulatory interests
   - Prospect of formal regulation in future if reputational not delivering
   - Unintended consequences eg companies more able to ignore stakeholders if Ofgem is not interested (in either the outcomes or in the stakeholders' views)
   - Stakeholders will expect Ofgem to know what is happening in the sector and see Ofgem as a trustworthy source

What this framework reinforces is that **reputational regulation is an important tool but not an easy option**. Ofgem also still need to actively engage themselves on those issues squarely within their remit (e.g. on reliable service, on vulnerability, on environmental impacts including carbon emissions). In the same way that Ofgem reports on the companies' financial performance under RIIO and in retail on the State of the Market, it should be providing **consolidated reporting on what the network companies are delivering in terms of outcomes**.

This framework also highlights the importance of a focus on **corporate purpose**. This needs to be recognised as a way of creating the **right culture** to deal with uncertainty and to ensure ongoing focus on delivering beneficial economic, social and environmental outcomes. **Where a company genuinely seeks to be a purposeful business that should be acknowledged and encouraged**. Our work on Fair for the Future is helping to take this debate forward across the energy, water and communications sectors.[33]

This also raises the question of what Ofgem sees as the end game for reputational regulation. Is it to drive companies to assume greater responsibility for both the outcomes they identify and for delivering against them, consistent with being a purposive company? Or is it just another tool in the regulator's toolkit for tracking progress against what are effectively regulator determined outputs ?

7. Vulnerability, local needs and no-one left behind

Ofgem rightly stresses its expectations of DNOs to support and protect consumers in vulnerable situations, as per its Consumer Vulnerability Strategy[34]. DNOs already have a role in prioritising those customers whose wellbeing is most at risk from a loss of supply and those either in, or at risk of, fuel poverty. The draft methodology highlights that as the energy system becomes smarter, cleaner and more flexible that DNOs must also consider changes to their role in protecting the interests of customers in vulnerable situations [35]. This is important and welcome.

We also welcome the proposed new strategy delivery incentive for ED2 which entails a 'two-stage' incentive approach to improving service standards for customers in vulnerable situations. **First, delivery of principles and baseline standards, set out in a new over-arching licence obligation – with ambition in company business plans stretched via the BPI/CVP process**. **And second, and important, a financial incentive on delivery against company vulnerability strategies as set out in their business plans, assessed twice in the ED2 period** (mid-review, at the end). We welcome the

[33] https://www.sustainabilityfirst.org.uk/images/publications/fair_for_the_future/Fair_for_the_Future_Project_._How_2_Guide_FINAL1.pdf
[34] Ofgem Consumer Vulnerability Strategy 2025. October 2019 https://www.ofgem.gov.uk/system/files/docs/2020/01/consumer_vulnerability_strategy_2025.pdf
[35] Annex 1. Para 6.2.

financial incentive as this should help maintain a focus on this very important area and will hopefully encourage DNOs to continue to look for new opportunities beyond those identified in business plans.

Individual company consumer vulnerability strategies will therefore be underpinned by Ofgem's principles and baseline standards - presently grouped under four headings: PSR, smart use of data, new forms of vulnerability in a smart system, and embedded approach. However, we also note **two important protection gaps in current Ofgem thinking – whether for company vulnerability strategies or for baseline standards** – and which we **would encourage Ofgem to address.** These are:

- **Inclusive services and accessibility** – a **stronger focus is needed on inclusive service provision because PSR-based approaches miss the vast majority of customers with additional needs who are not on the Register**. It is essential for customers **to access all DNO services in an easy and timely way**, especially when things go wrong**.** This is now even more so, given the pandemic. **An inclusive approach can be more cost effective**, enable a better customer experience and is in line with Ofgem's own updated Consumer Vulnerability Strategy. Inclusive services remain an area where network companies have made slow progress despite the relative low cost of action and ample examples of good practice[36]. **We propose that Ofgem take three additional steps to address this accessible service gap :** to include 'accessible and inclusive service' as an area that companies must consider as part of their consumer vulnerability strategies ; to consider a common reputational metric for all DNOs for inclusive service provision, designed to complement the proposed PSR satisfaction metric ; and to monitor and report on service provision for customers with additional needs for inclusion in Ofgem's annual consumer vulnerability report (as Ofgem does for energy suppliers).

- **Customers' wider safety needs** – It is important for Ofgem to actively signal to companies the importance of ensuring wider customer safety. This could be done by **adjusting the wording of the relevant requirement and principle**. In company consumer vulnerability strategies and Principle 1 there is a welcome focus on 'vulnerability to a loss of supply', but in practice this is too narrow. Companies should be encouraged to consider *all of their customer and consumer touch points* that can impact how safe customers feel (for example, home visits, hazard to certain customer groups caused by street works etc) **[37].** Given the importance of ensuring all customers stay safe during supply interruptions, Ofgem may want to consider a dedicated post-interruption customer satisfaction measure – to capture the experience of those *not* on the PSR, but who still might have needed help.[38] The pandemic accentuates the importance of this point.

Additional points from Sustainability First on Ofgem's ED2 approach to incentivising DNO vulnerability strategies, proposed vulnerability principles and associated standards include :

- **Affordability** – The focus on affordability is particularly welcome. As a result of the Covid-19 pandemic more people are struggling to afford their energy bills. We recognise Ofgem's regulatory stance regarding cross-subsidy in this area and that it considers fuel poverty to be a matter for national and local government. However, Ofgem needs to learn the lessons from the

[36] See our answer to OUTQ20 p.33 below for more detail
[37] See our answer to OUTQ20 p.33 below for more detail
[38] As Ofgem's CVS acknowledges - which includes a question about whether customer safety needs were met.

gas distribution draft determination and **provide greater clarity on the extent to which it will listen to customer and stakeholder feedback in this area in terms of the scale of support and the types of measures that DNOs might propose that will be accepted – ensuring sufficient flexibility to respond to changing government proposals and customer needs and priorities.** For example, on **energy efficiency i**n the gas draft determinations Ofgem took a firm line that funding energy efficiency was not appropriate, given the wider schemes available and this has subsequently come under criticism. In our view, if DNOs can argue that they are best placed to lead this in a particular circumstance (eg linked to avoiding reinforcement of the network) then that to us would be a legitimate extension of their role. This appears to be accepted in the draft ED2 Business Plan Guidance but confirmation would be helpful.

- **Local community priorities and needs** - linked to the above points, we would also encourage Ofgem to look more widely at the lessons learned from the gas distribution draft determinations which left stakeholders **feeling that the effort put into developing ambitious proposals which reflected local priorities was wasted**. Having encouraged engagement **Ofgem ultimately took the view that national standards were more appropriate and that the UIOLI pot should simply be allocated pro-rata to customer numbers - regardless of the proposals put forward or regional differences in need.** Ofgem has highlighted its desire to ensure that good practice is shared. **It will be important for Ofgem to signal as early as possible those areas where it would like to see common minimum standards. There should be sufficient flexibility to respond to different regional needs and community priorities.**

- On the question of '**no-one left behind**' **we strongly support this as an essential consideration for the energy system transition**. This has been a core focus of much of the work of Sustainability First. One specific manifestation of this could be to ensure that **thought is given to the role that smart electric storage heating can play in the decarbonisation of heat and in the provision of flexibility services to the DNOs, initially perhaps off the gas-grid, but not just.** As set out in the Grid Edge Policy paper on electric storage heating which Sustainability First contributed to[39], electric storage heating tends to be used by those on lower incomes and also is a neglected element of thinking around heat decarbonisation despite its clear benefits as a source of flexibility and as a practical solution for smaller properties that physically could not accommodate a heat pump (or where the upfront costs of a heat pump means it is not cost effective). We would encourage Ofgem to give this as an example of the sort of area where DNO engagement could be beneficial.

- **Ofgem intervention on standards** – Ofgem should send a clear signal that it will intervene to set higher standards for customers where a company's proposed consumer vulnerability strategy is not just out of line with baseline standards but also out of line with stakeholder expectations and customer and community needs.

- **Removal of SECV[40] –** Sustainability First's 'Energy for All' research found that the stakeholder engagement and consumer vulnerability incentive had "helped to prompt a sea change in activity to engage with and support customers with additional needs." This was very positive. The incentive was however initially designed to catalyse cultural change which now should be

[39] 'An Electric Heat Pathway: Looking Beyond Heatpumps' available here.
[40] Stakeholder Engagement and Consumer Vulnerability Incentive

embedded (though isn't always). Our research also found that the engagement undertaken was often not strategic, that approaches focussed on 'whizzy initiatives' sometimes at the expense of consistent good practice delivery. In addition, there was no mechanism to ensure schemes which were funded by customers actually then became business as usual (many of them didn't). **We think it's appropriate for the SECV approach to discontinue**. **Innovation funding will continue to be provided under the NIA, which as mentioned below is needed and welcome**. Having a **focus on a Consumer Vulnerability Strategy will help to take embedding consumer vulnerability within company cultures to the next level, ensuring that consistently good practice and strategic approaches are rewarded rather than just ad-hoc initiatives**. That said, Ofgem may want to consider how it continues to incentivise good quality partnership working in this area as a clear expectation of the vulnerability strategy principles. One approach would be to have a **stakeholder satisfaction measure** (as against a customer satisfaction measure) **to look at the satisfaction of different stakeholder groups working with and on behalf of customers in vulnerable situations**.

- **Ofgem 'credibility' on standards-setting –** it will be important for Ofgem to demonstrate legitimacy by showing that it has itself engaged directly with a wide range of consumer vulnerability organisations (beyond the usual suspects) in designing the ED2 methodology - in particular the principles and base-line standards. **We would encourage Ofgem to proactively contact organisations that are impacted by the decisions in this area e.g. disability and age organisations in particular who historically may not have been well-represented in discussion**.

- **Reporting -** in line with good practice we would **expect companies to publish regular updates on their vulnerability strategy** regardless of their formal reporting requirements to Ofgem. **As a minimum we would encourage companies to publish an annual report on the accessibility, safety and affordability services they provide to customers**, to show how company practice compares in Ofgem's annual consumer vulnerability report. It will also be important **after the mid-period and post-review assessments for Ofgem to produce a full report to compare and benchmark company performance, to highlight lessons learned and examples of good practice**[41].

Four additional areas on customer vulnerability in the ED2 draft methodology that we welcome are :

- The encouragement given to DNOs to develop a **common SROI methodology** (social return on investment) to support reporting in this area. We hope that lessons from this work on electricity distribution can flow through into other sectors and gas distribution in particular. However, SROI should not be used as the basis of calculating CVP rewards.

- The proposal for an overarching **principles-based licence obligation on DNOs to treat their customers fairly**, including those in vulnerable situations, **through-out their operations**. However, this will be meaningless unless it is properly monitored and as mentioned above could

[41] See Sustainability First Project Inspire – Energy for All, Innovate for All. Jan 2019. https://www.sustainabilityfirst.org.uk/images/publications/inspire/Energy%20for%20All-%20Innovate%20for%20All%20(full).pdf

be easily supported by a focus on accessibility, inclusive services and broader safety in company consumer vulnerability strategies.

- The inclusion in the **Network Innovation Allowance** of **innovation projects for customers in vulnerable circumstances** and the requirement for all NIA projects to consider any vulnerability impacts. As noted in our Sustainability First 'Energy for All' report, consumer vulnerability innovation can be more complex and riskier than 'standard innovation' and culturally a number of companies have still not properly embedded addressing the needs of all customers into their approaches. This **innovation stimulus is therefore especially valuable and needed.**

- The steps Ofgem has taken to articulate **minimum baseline services** expected by DNOs. This is a positive step. As noted, we would **encourage Ofgem to ensure that a representative range of stakeholders including disability groups have informed these standards**. The challenge will be to keep this knowledge of what is good practice up to date.

But for each of these four areas the devil will be in the detail and therefore important to get right.

We hope that these high-level comments from Sustainability First regarding wider sustainability considerations for the ED2 methodology consultation are of help to Ofgem and we would of course be happy to discuss any of the points raised.

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Annex:
Sustainability First Response to specific ED2 SSM Consultation Questions

Overview Document

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

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

Net Zero and Innovation

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

It is important to retain some flexibility with adaptive regulation to re-set ED2 allowances to align / re-align RIIO2 price control outputs with major changes on net-zero, be that legislation or policy. This is especially so for any major clarification of GB heat policy. We agree that the net-zero re-opener should be a 'last resort' mechanism - for use where other uncertainty mechanisms or innovation funds are inappropriate and where policy or legislation was largely unclear at the point of final business plan determinations. For this reason, we agree with the wide scope Ofgem lists (e.g. material changes in government policy, major technological changes, or whole system developments). We welcome the fact that the Net Zero reopener is only intended for use where other uncertainty mechanisms are not appropriate and with a high materiality threshold (e.g. >1% of base revenue). There are also questions about practical operation including whether companies should also have the ability to trigger a reopener. While not wishing to see gaming of 're-opener' routes, from a net-zero standpoint both companies and Ofgem may need the flexibility to trigger a net-zero reopener.

Funding strategic investment in ED2 Q5-Q9

Summary of Sustainability First key points on strategic investment

In considering how strategic investment is to be sufficiently funded in ED2 to make appropriate progress on net zero '*at least cost to customers*', there is some **important sequencing for Ofgem yet to address.**

First, **reform of distribution access charges** is a welcome and important step in facilitating connection of new distributed generators and new LCTs to progress net-zero delivery. However, some major outstanding questions remain, including on where the boundary for recovery of the costs of upstream distribution network reinforcement will be drawn in the future – see our answer to question OVQ30 below.

Second, **we support the principle of adaptive regulation for net-zero** given future uncertainty and likely variability on the uptake, pace and location of connections for new distributed generation and low-carbon technologies on the distribution networks.

However, it **also seems important for the companies to have some line-of-sight in the final ED2 SSM on the likely split between investment which might reasonably expect to sit within base-line revenues and the proportion of investment subject to uncertainty mechanisms triggered later in the price control period**.

In considering this split, Ofgem needs to acknowledge that the nature of investment at distribution voltages is fundamentally different from transmission – with very many more smaller individual projects. The appropriate initial split of revenues allocated to baseline allowances therefore may arguably be different for distribution than transmission. **To make timely progress in ED2 towards net-zero, Ofgem needs to recognise the importance of at least some 'headroom' for DNOs to be sufficiently agile in facilitating and delivering many new connections** (including alternatives to new network investment). DNOs must be in a position to respond to the well-evidenced net-zero needs of others in a timely way. If a high proportion of future connections-related investment ends up sitting outside baseline allowances – and / or enabled only via uncertainty mechanisms for later agreement either through reopeners or with risks around how it would be treated in a more automatic mechanism) - then there is a danger that the DNOs could needlessly slow the legitimate net-zero ambitions and targets of others. Or, DNOs may be at risk of developing and operating their networks in a needlessly inefficient or piecemeal way.

In particular, **to support a moderately good future line-of-sight for the companies on baseline allowances, Ofgem will need to give more thought to its proposals on uncertainty mechanisms**[42]. There is value to Ofgem in having a wide range of mechanisms for dealing with uncertainty.

The **idea of a PCD with a trigger linked to regional plans** is a useful additional mechanism where costs are lumpy and is welcome. More thought however is needed as to the detailed nature of those triggers. In general, **we would also expect volume drivers to have a particularly important role in ED2.** But, the challenge of identifying a suitable cost-driver is significant. For example, costs will vary depending on the level of locational clustering and / or the extent of flexible usage of smart-technology (for more on this see our answer to QOVQ9).

In addition, Ofgem also needs to set out more clearly its own thinking on the circumstances, if any, where Ofgem might see it as appropriate for DNOs to adopt a 'touch the network once' approach'[43]. For example, in sizing new connection assets, what criteria might Ofgem apply to DNO proposals on whether to build-in headroom at the outset (and how much headroom) to the benefit of future network-users – both at the point of connection and also for any knock-on upstream capex (ie presumably a DNO will need to demonstrate via a CBA options analysis the long-run benefits and cost-effectiveness of their proposed approach).

[42] Appendix 3. A3.2 p 82. Uncertainty Mechanisms. Presented as either (1) a PCD with funding triggers based on a regional plan (eg award of government funding, phase out of gas boilers) or (2) Volume Drivers – LCT volume driver, or, Capacity volume driver.
[43] para 4.41 Overview p 34

Summary of Sustainability First key points on forecasts, scenarios and approaches to strategic investment in ED2

Forecasts, scenarios, the Distribution-FES and local area energy plans produced by local authorities – informed by thorough and systematic stakeholder engagement - each have a major role in informing and demonstrating the underlying evidence-base and realism of company ED2 business plans. These are **important areas to get right – both in combination and in terms of sequencing overall**, including for judging outcomes on the BPI/CVP incentives.

Critically too, the outputs of these forecasting / scenarios exercises will also inform Ofgem decisions on how far investment allowances are to be treated from the outset as baseline (i.e. where 'certainty' is robustly evidenced) and how far allowances should be subject to uncertainty mechanisms (because more 'uncertain').

Getting forecasts 'right' is an impossible task. So, very importantly, if as proposed above, **price control deliverables within baseline are well-designed and there are clearly quantified volume drivers** (e.g £x/MW or £y/MWh) **-** with appropriate levels of periodic audit and reconciliation - **then the importance of getting forecasts and scenarios 'right'** – in order to provide assurances on net-zero 'at least cost to consumers' – **potentially reduces significantly** while addressing uncertainty and still offering companies some forward line-of-sight to plan ahead.

In its four models (A-D) for addressing uncertainty, Ofgem differentiates between **a centralised approach to setting forecast outputs** (with (A) more certain or (B) less certain - **against a decentralised approach to determining forecast outputs** (with more certainty (C) or less certainty (D). In our view, this thinking is needlessly binary as between 'central' and 'decentralised'. There is a clear place both for a central view and a DNO-level decentralised view – and where timely engagement, iteration and transparency must inform both. It is also clear that for core cost categories there is a high level of uncertainty and hence the variants B and D which incorporate volume drivers seem to be the way forward.

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

In practice, a centralised approach to deciding forecast outputs for ED2 **seems largely inappropriate**. Top-down forecasts of likely regional development of renewables and LCT uptake will inevitably be relatively poorly informed. Nevertheless, **indication of top-down expectation on some key assumptions and outputs for the ED2 period will offer basic benchmarks** – necessary to the companies, their stakeholders including the CEGs, Ofgem and the Challenge Group – by which to question and in the end to understand and judge outliers in companies' individual decentralised forecast outputs. As a minimum, indication from Ofgem of top-down 'central' forecasts would be helpful on : (1) HMT / OBR central forecasts on post-Covid annual economic growth to 2030 (national, regional); (2) DfT and manufacturer forecasts on potential *pace* of EV uptake; and (3) rate of expected heat electrification nationally and regionally - as informed by *current* government policy.

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 OVQ4 above

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

Each DNO must produce a D-FES (tied into the national FES) and a Long-term Development Plan. They must also demonstrate a strong process on engagement to inform their own forecast outputs. Given the fundamental switch to decentralised energy and LCTs since ED1, it is self-evident that decentralised approaches to determining forecast outputs must become a cornerstone of the ED2 methodology. At the same time, reliance on largely decentralised forecasts of outputs to determine ED2 allowed revenues brings new challenges for the companies, stakeholders, Ofgem and for others to establish well-assured business plans. **New common frameworks, processes and checks need to be developed by DNOs - and agreed with Ofgem - to satisfactorily demonstrate the robustness of the underlying evidence put forward in individual ED2 business plans and how they relate to national level forecasts around policy development for example**. Demonstration of these processes and frameworks must under-write Ofgem and stakeholder confidence in DNO forecasts on volumes and expected timing of new renewable and LCT connections across their networks.

The outcome of the BPI / CVP incentive should link clearly to the steps taken by DNOs to develop and evidence their decentralised forecast outputs including :

- Demonstration of **a strong and systematic *process* across their full geography** to engage on, to inform and to test DER & LCT forecast outputs for the ED2 period in line with net-zero expectations. This to include underlying growth assumptions for the pandemic recovery.
- Adoption of **a framework and process common across all DNOs** - **as suggested by the Scottish Government in Ofgem's ED2 Over-Arching Working Group** – to enable devolved, regional, or local authorities with active net-zero commitments and / or who expect to go faster than 2050 – **to demonstrate to the satisfaction of the DNO** that their ambitions are potentially funded, achievable and robust, including realistic consideration of **potential network options within ED2 time-frames**[44].
- **Information and support provided for connectees to make economic choices on DER & LCT connections** through heat-maps and similar initiatives (i.e to tie into the Large Connections Strategy Delivery incentive)
- Clear demonstration of how forecast outputs for DERs & LCTs are fed into ED2 business plan proposals **for non-network alternatives and / or for future optionality**.

Because it will underpin so much else in ED2, the quality and timely delivery by DNOs of their completed decentralised forecast outputs and scenarios is vital to the wider success of the ED2 price control process. The outcome of the BPI / CVP incentive should therefore link clearly to these two elements of the BPI.

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[44] The draft Local Area Energy Plan best practice guidance from CSE and ESC is a helpful document. In the first instance, this aims to inform local authorities on how to develop robust energy plans to support them in their approaches to others, including to DNOs, Ofgem or government.

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 OVQ6 above

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?

While we welcome this very helpful guidance the point was made strongly at the OAWG by the Scottish Government that there needs to be flexibility for example to accommodate plans that at this stage only deal with certain aspects of the energy transition. The LAEP guidance was targeted at both the networks and at local government to help them in carrying out plans and input should not be disregarded if it does not meet all the criteria listed.

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

There is value to Ofgem in having a wide range of mechanisms for dealing with uncertainty. The **idea of a PCD with a trigger linked to regional plans** is a useful additional mechanism where costs are lumpy and is welcome. More thought however is needed as to the detailed nature of those triggers.

In general, **we would expect volume drivers to have a particularly important role in ED2**. The challenge of identifying a suitable cost-driver is significant. For example, costs will vary depending on the level of locational clustering and / or the extent of flexible usage of smart-technology. In finalising the ED2 SSM, Ofgem will need to work with DNOs to identify the best approach. None will be perfect but these volume-driver mechanisms do provide important protection for both companies and customers in the face of uncertain demand and at the same time offer the potential to avoid the delays and uncertainty associated with reopeners.

With a robust volume driver it may in the end matter significantly less what central forecast is adopted for the business plan. But while this may have less impact on company revenues, whichever forecast is adopted as 'central' nevertheless remains very important in terms of company planning and engagement. We would encourage Ofgem to set volume forecasts with a level of headroom that provides confidence net zero can be met – while recognising that revenues can be clawed back through the volume driver if the volumes do not materialise.

While we understand Ofgem's desire to incorporate some sort of utilisation incentive alongside any capacity volume driver to ensure that capacity added is of value to consumers, this clearly adds complexity. There are also risks in an undue focus on utilisation in the ED2 period of what are essentially long term assets. Care is also needed to avoid discouraging investment in the final year of the price control if utilisation is measured at the end of the period. Given the programme of investment needed to deliver net zero companies should be thinking about how best to programme this across price controls and how to maintain a supply chain. The incentive framework must support this.

The inclusion of an LCT incentive or a utilisation incentive without any financial incentive to manage losses also risks distorting decision making and leading to higher losses, with associated carbon emissions. We argue below for a stronger incentive on losses to address this (see OUTQ61).

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

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

First, we wholeheartedly agree with the effort to coordinate the Ofgem strategic innovation fund (SIF) with other government innovation funding. Sustainability First has been a long-standing advocate for this. We see this as particularly valuable for innovation funding for transport and heat. One caveat, with current pressure on public sector spending, government may look for more to be done through the SIF (so, customer-funded). Second, we recognise the case for Ofgem identifying 'challenges' that SIF bids must respond to. However, industry should also be engaged in this process as they will have a better understanding of the technical engineering challenges that the networks face in the transition which Ofgem has less visibility of.

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

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

We very much welcome the proposal on **NIA funding that innovation projects for customers in vulnerable situations should be a priority in ED2**.

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

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

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 support the steps Ofgem is putting in place to make better use of energy data through cross-sector licence obligations and encouraging company data strategies. We are very supportive of the work which BEIS and Ofgem are leading on the Modernising Energy Data Programme.

DNOs will have access to customer smart-meter data for their own planning and operational purposes (subject to Ofgem agreeing their privacy plans). We still have a concern however that neither government nor Ofgem will have equivalent access to customer smart meter data for a public interest purpose, including market oversight (even if aggregated, anonymised). On this, Sustainability First together with CSE has been leading the multi-partner PIAG project[45]. In 2020 we have published two papers, relevant to the modernising energy data programme, setting out our

[45]Public Interest Advisory Group on access to smart-meter data for a public interest purpose https://www.smartenergydatapiag.org.uk/

concern at the lack of access by government[46] and the regulator[47] to granular half-hourly customer-side data to carry out their functions.

We have also encouraged Ofgem in its reform programme for market-wide half-hourly settlement to keep the door ajar on eventual access to smart-meter data for a public interest purpose[48]

There may also be potential for the DNOs to make available aggregated or anonymised smart meter data – for example to aid in local area energy planning. It is unclear at present whether this should be within scope of the open data arrangements being put in place. Further guidance is needed from Ofgem around the privacy and other implications of what could be an important initiative.

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 feel that in the ED2 period, both Ofgem and the companies should focus as a priority on shaping the activities, role and remit of the DSO and developing and implementing an appropriate incentive package.

At this point developing institutional plans for future DSO separation seems significantly premature. Not least, until we are further into the energy transition there may be a strong case to maintain closely integrated arrangements between the DSO and DNO. Not least to maintain a geographic overview on progress towards net-zero in a DNO area, including on new investment and the most economic actions to reduce DNO business carbon footprint (eg on Losses).

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?

Yes. However it is important that any 'revealed standards' are properly tested with the DNOs - and also with stakeholders more widely - before being imposed on other companies.

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

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

[46] Government approaches to published data and statistics for energy consumption https://d37809f7-dc9f-4c4f-835a-410a5acfa633.filesusr.com/ugd/ea9deb_093531e8c1b748659aa74263da4707d1.pdf

[47] Regulatory assessments and system efficiency : potential benefits of smart-meter energy consumption data https://d37809f7-dc9f-4c4f-835a-410a5acfa633.filesusr.com/ugd/ea9deb_f6c7acce92ec44b4854b30a39785772a.pdf

[48] Sustainability First response to Ofgem consultation on market-wide half-hourly settlement. September 2020 https://www.sustainabilityfirst.org.uk/images/publications/consultations/SF_MHHS_response_130920.pdf

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 agree with this approach which both ensures that companies do deliver on their commitments and also continue to look at how they can go further as the price control period develops.

As part of the DSO strategy delivery incentive we should also like to see a strong Ofgem expectation of close coordination with the ESO on network planning and development, on network operation and on whole system and market development, including for flexibility but not just.

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

The proposed approach seems to strike the right balance. More regular assessments would be burdensome and simply leaving it until the end of the control creates risks for the companies in understanding how the incentive will be applied in practice. The mid-period review allows time for companies to up-their-game if it is clear that they are not meeting the standard expected.

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

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 are concerned that the DSO role, principles and associated baseline expectations **make no reference whatsoever to the DSO role in supporting net-zero outcomes or delivery nor to the DSO contribution to reducing the business carbon footprint of its own DNO[49]**. **This is a significant omission.** We have found only a single passing reference to carbon in the DSO section of the draft SSM – regarding required information provision for ancillary services[50].

The DSO should be given an additional licence obligation to have regard to decarbonisation and net-zero across all of its activities and roles - investment planning, operation, despatch and market development.

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?

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

[49] In Appendix 5 of the draft ED2 methodology on DSO roles and principles (pages 97-106) – across discussion of the three proposed 'roles' and the five principles for baseline standards

[50] Principle 3.1 : Market development. Provide accurate, user-friendly and comprehensive market information. Baseline expectations. P.103 – on 'historic and future DSO ancillary service market actions', to include tender results, prices bid and paid, **the carbon content of aggregated units**, how often DER is despatched (and volumes) and other actions taken by the DNO (with anonymization of DER as required), including curtailment as part of non-firm connection agreements.

See our answer to question OVQ7 above. We think that the quality and timeliness of the decentralised DNO Forecast Outputs, Scenarios & the DFES should be included as an additional category for the CVP in the BPI

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

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

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

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?

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?

Reform of distribution access charges is a welcome and important step in facilitating connection of new distributed generators and new LCTs to progress net-zero delivery. However, some major sequencing and other outstanding questions remain, including on where the boundary for recovery of the costs of upstream distribution network reinforcement will be drawn in the future i.e. whether connection charges will become 'shallower' or 'shallow'. This matters because it will re-define what proportion of upstream network reinforcement costs will be borne by an individual connection customer (or group of customers) and what proportion will be borne by the distribution networks with those costs socialised via distribution charges across all customers. The draft ED2 methodology recognises that 'there are some key interactions between Access SCR & ED2. Access and charging reforms may change the scope of what is included in the sector price control. The change in scope as a result of reforms could reflect changes in the triggers for investment, the amount of investment expected, or in how investment costs are recovered' (8.4 & table 13. Potential impact of Access SCR on RIIO-ED2. P 72). Ofgem is due to publish its 'minded to' consultation on access later this year.

One major area where Ofgem's final decisions on access reform will significantly matter is in the total sums likely to be funded in the ED2 period – either for base-line or for strategic investment via uncertainty mechanisms. Ofgem has given guidance to the companies on the assumptions they should use in their Plans. However there are also potential implications for the SSM itself which need to be thought through. One of these, as noted , relates to the level of upstream load-related capex to be funded via price control allowances and the implications, if any, for design of uncertainty mechanisms.

Last, and linked to reform of access charges above, the interplay between competition in connections also needs consideration against wider strategic investment objectives.

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?)

This seems like the only practical approach.

However our concern is that this doesn't just affect the Business Plan proposals but has the potential to impact the design of incentives and uncertainty mechanisms. In reaching its decisions on the SSM it is important that Ofgem has been through an exercise to test that decisions on incentives and uncertainty mechanisms are robust against potential changes that might be made through the SCR. The SSMD will then hopefully be aligned with the 'minded to' decision but Ofgem will need to set out how its SSMD will be adjusted if the final decision on the SCR is different.

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

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?

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?

For customers in vulnerable situations – see our answers to questions OUTQ20 – OUTQ22 below. In particular see our response to OUTQ20 where we note that a major omission across customer vulnerability strategies plus the principles and baseline standards is **'inclusive services'. This is particularly important for DNO services in managing the potential longer term impacts of Covid-19 for *all* customers, including those in vulnerable situations.**

For strategic investment, uncertainty mechanisms with volume drivers should to some extent manage the longer term impacts of COVID-19.

See also our answer OVQ4 above on central forecasts. We believe that these should include indication of top-down expectation on some key outputs for the ED2 period including (1) HMT / OBR central forecasts on post-Covid annual economic growth to 2030 (national, regional); (2) DfT and manufacturer forecasts on potential *pace* of EV uptake; and (3) rate of expected heat electrification nationally and regionally - as informed by *current* government policy.

Ofgem Annex 1 - Delivering value for money services for consumers

Approach to setting outputs and incentives

OUTQ1: Do you agree with our proposal for setting upper and lower limits on the value of bespoke ODIs?

OUTQ2: Do you agree with our proposal for a minimum value for bespoke PCDs?

Meet the needs of consumers and network users: Customer satisfaction

OUTQ3: Do you agree with the proposed scope and associated customer category weightings for the satisfaction survey?

OUTQ4: Do you agree with our proposed approach to target setting and calculating rewards and penalties in RIIO-ED2?

OUTQ5: Do you agree with our proposed approach to setting complaints metric targets in RIIO-ED2?

OUTQ6: Do you agree with our proposal to remove the Stakeholder Engagement and Consumer Vulnerability Incentive in RIIO-ED2?

Meet the needs of consumers and network users: Connections

OUTQ7: Do you agree with our proposal to expand the connections element of the customer satisfaction survey?

OUTQ8: Do you consider that we have identified the relevant considerations to determine which customers should be captured in its scope?

OUTQ9: Do you agree with our proposal to retain the TTC incentive as a financial ODI in RIIO-ED2?

OUTQ10 - Do you agree with our proposal to include a reopener which allows us to revisit targets, and potentially introduce penalties, in the period?

OUTQ11: Do you agree with the methodology we propose to use to set the new TTC targets?

OUTQ12: Do you have views on our proposed Connection Principles and associated standards (in Appendix 4) for RIIO-ED2? Do you disagree with any of the standards we have proposed? If so, why?

OUTQ13: Do you have views on our proposal to use the Business Plan Incentive to encourage companies to reveal higher baseline standards of performance and to apply this, where appropriate, to all DNOs?

While we recognise the value in being able to push up baseline standards it is important that any 'revealed standards' are tested with the other DNOs and with stakeholders before being applied. This is particularly important in areas around customer service where companies are likely to have undertaken extensive consumer engagement and willingness to pay research and where priorities may vary by region.

OUTQ14: Do you agree with our proposal to use an ex post assessment to penalise/reward companies who fail to deliver their strategies in line with our guidance/exceed performance targets?

Yes – see OUTQ57 below.

OUTQ15: Do you consider that an assessment of performance in the middle and at the end of the price control is a proportionate approach?

Yes – see OUTQ57 below

OUTQ16: Do you agree with our proposal to retain the Connections GSoPs for all connection customers in RIIO-ED2?

OUTQ17: Do you agree with our proposed approach to uplifting the Connections GSoP payment values in line with inflation, indexing payment levels to inflation, and rounding to the nearest £5?

OUTQ18: Do you agree with our proposal to remove the Incentive on Connections Engagement for RIIO-ED2?

Meet the needs of consumers and network users: Consumer Vulnerability

OUTQ19: Do you agree with our proposed approach to ensuring consumers in vulnerable situations receive an appropriate range and level of support in RIIO-ED2? If not, what alternative approach should we consider?

Ofgem rightly stresses it expectations of DNOs to support and protect consumers in vulnerable situations, as per its Consumer Vulnerability Strategy. DNOS already have a role in prioritising those customers whose wellbeing is most at risk from a loss of supply and those either in, or at risk of, fuel poverty. The draft methodology highlights that as the energy system becomes smarter, cleaner and more flexible that DNOs must also consider changes to their role in protecting the interests of vulnerable customers[51]. This is important and welcome.

We also welcome the proposed new strategy delivery incentive for ED2 which entails a 'two-stage' incentive approach to improving service standards for customers in vulnerable situations. **First, delivery of principles and baseline standards, set out in a new over-arching licence obligation – with ambition in company business plans stretched via the CVP/ BPI process**. **And second, and important, a financial incentive on delivery against company vulnerability strategies as set out in their business plans, assessed twice in the ED2 period** (mid-review, at the end). We welcome the financial incentive as this should help maintain a focus on this important area and will hopefully encourage DNOs to continue to look for new opportunities beyond those identified in business plans.

We note two important protection gaps relating to company customer vulnerability strategies and Ofgem proposals for vulnerability principles and baseline standards which we would encourage Ofgem to address – see Q20 below.

OUTQ20: Do you have views on our proposed Vulnerability Principles and associated standards (in Appendix 5) for RIIO-ED2? Do you disagree with any of the standards we have proposed? If so, why?

We note **two important protection gaps** relating to company customer vulnerability strategies and Ofgem proposals for vulnerability principles and baseline standards **which we would encourage Ofgem to address[52]**.

Inclusive services:
Greater focus is needed on inclusive service provision – this can be a more cost effective approach, enable a better customer experience, is in line with Ofgem's own updated Consumer Vulnerability

[51] Annex 1. Para 6.2.
[52] The four vulnerability principles and baseline standards are set out under the following headings : PSR, smart use of data, new forms of vulnerability in a smart system, and embedded approach.

Strategy, and is an area where there has been slow progress by network companies despite the relative low cost of action and ample good practice.

Rationale: It is essential that customers can access all DNO services in an easy and timely way, particularly when things go wrong.

The majority of Ofgem's accessibility proposals (with the exception of website accessibility outlined in the baseline services) are focused on customers on the PSR. E.g. providing information for PSR customers in formats suited to a range of additional communication needs (as per existing licence conditions); having dedicated lines / prioritisation for customers registered on the PSR; and a PSR customer satisfaction measure.

However, **PSR based approaches miss the vast majority of customers with additional needs who are not on the Register**. As Ofgem states in its latest consumer vulnerability annual report "We acknowledge that using PSR data alone does not provide the full picture as a person may be in a vulnerable situation, but not require priority services available from the PSR in relation to their access, safety and communication needs."[53]

In part to address the 'accessibility gap' the regulator in its Consumer Vulnerability Strategy 2025 (CVS) encourages inclusive design. The idea behind this is that if companies design *all* services so that they can be used by as many people as possible regardless of age, background, disability, or wider circumstances, it will increase ease of use and accessibility for everybody (and reduce customer contacts). Tailored PSR services will still be required, but not as many and the approach ends up being cheaper as well as improving customer experience. As Ofgem states in Outcome 4A of its CVS: "We want products and services to be designed to meet the needs of a wide range of consumers (including the most vulnerable)"[54].

There is a huge amount of good practice already available on inclusive design including by Sustainability First's Project Inspire 'Innovate for All' report[55], which was part funded by Ofgem. The latter provides practical examples as to how companies can deliver improvements. Much of this is low cost, yet beyond more accessible websites, inclusivity is still not embedded into DNO practice and incentives for improvements in this area are therefore still required. This needs to be addressed.

While it is unclear how long the impact of Covid-19 will be felt, it is clear that **the pandemic has increased the importance of energy companies having inclusively designed services**. Face to face support is harder to access and historic community support services available to many customers with additional needs are no longer available as provision is closed due to resource and financial challenges.

If the new consumer vulnerability principle is introduced in a comparable way as for energy suppliers, in order **to comply with 'treating customers fairly', DNOs will need to meet all customers differing needs, not just those on the PSR.** While this should support more inclusive approaches, in practice experience from the supply side indicates progress remains slow and it is hard to monitor this licence condition in practice, let alone enforce it. To address this accessible service gap, to learn from the lessons on the supply side, meet customers' expectations, and ensure improvements are delivered, **we recommend that Ofgem take three additional steps:**

[53] https://www.ofgem.gov.uk/system/files/docs/2019/09/vulnerable_consumers_in_the_energy_market_2019_final.pdf p.19 para 1.23
[54] https://www.ofgem.gov.uk/system/files/docs/2020/01/consumer_vulnerability_strategy_2025.pdf
[55] https://www.sustainabilityfirst.org.uk/inspire

a) **Include 'Accessible and Inclusive Service' as an area that companies have to consider as part of their consumer vulnerability strategies**. This is a simple step. Failure to do so would be inconsistent with Ofgem's own CVS. Most inclusivity approaches are relatively low cost.
b) **Consider a common inclusive service provision reputational metric for all DNOs -** this could complement the proposed PSR satisfaction metric, and would effectively update Ofgem's approach in line with the CVS and customer expectations. We are happy to discuss how this might best be done.
c) **Monitor and report on service provision for customers with additional needs** (as Ofgem does for energy suppliers). This includes the types of service offered, the number of services provided and to which customer segments, to ensure the licence condition is delivering in practice to all groups not just 'easy to access consumer vulnerability groups'. This comparable information can then be published in Ofgem's annual consumer vulnerability report.

Wider safety needs:

The focus on 'vulnerability to a loss of supply' in company's consumer vulnerability strategies and Principle 1 is very welcome but too narrow. **We'd encourage Ofgem to adjust the wording of this requirement and the principle so that it captures customers' wider safety needs**. Companies should be encouraged to consider *all of their customer and consumer touch points* that can impact how safe customers are and feel. For example:

- Home visits can be a source of genuine anxiety for many customers. The licence conditions in this area are arguably out of date and requirements such as provision of a password arguably do not meet rising customer expectations. There has been little innovation in this area despite readily available technology and good practice sharing. Safety and peace of mind during home visits has arguably become more important in light of Covid-19, against a context of rising mental health problems, with home isolation and social distancing yet the latter is not included in the agreed energy/water company PSR needs codes.
- It's well recognised that poorly designed and communicated street works can be a real hazard for many customers e.g. those who are blind and partially sighted customers and those with mobility problems.
- A number of network companies perform an important safeguarding role, working with social services and local organisations to flag customers who they notice during home visits are at risk. This kind of work needs to be actively encouraged to continue.
- Importantly, following customer and stakeholder engagement companies may identify wider opportunities to safeguard customers, where DNOs have 'the competence' and are 'best-placed position to deliver that support'. The energy system transition and the smartening of energy networks may also, as noted, result in new kinds of risks to customers which need to be addressed.

It's important not just to enable flexibility in this area, but for Ofgem to actively encourage and signal to companies that they must think about their wider safety impacts on customers.

In addition, given the importance of ensuring customers stay safe during supply interruptions, Ofgem may want to consider a dedicated post-interruption customer satisfaction measure that captures the experiences of those *not* on the PSR, but who still might have needed help (as Ofgem's CVS acknowledges) which includes a question about if their safety needs were met.

We wish to make the following additional comments on Ofgem's approach to incentivising DNO vulnerability strategies, proposed vulnerability principles and associated standards in ED2

- **Affordability** – The focus on affordability is particularly welcome. As a result of the Covid-19 pandemic we can expect more people to be struggling to afford their energy bills. We recognise Ofgem's regulatory stance regarding cross-subsidy in this area and that it considers fuel poverty to be a matter for national and local government. However, Ofgem needs to learn the lessons from the gas distribution draft determination and **provide greater clarity on the extent to which it will listen to customer and stakeholder feedback in this area in terms of the scale of support and the types of measures that DNOs might propose that will be accepted – ensuring sufficient flexibility to respond to changing government proposals and customer need and priorities.** For example, on **energy efficiency i**n the gas draft determinations Ofgem took a firm line that funding of energy efficiency was not appropriate, given the wider schemes available and this has subsequently come under criticism. In our view, if DNOs can argue that they are best placed to lead this in particular circumstance (eg linked to avoiding reinforcement of the network) then that to us would be a legitimate extension of their role. This appears to be accepted in the Business Plan Guidance but confirmation would be helpful.

- **Local priorities and needs** - linked to the above points, we would also encourage Ofgem to look more widely at the lessons learned from the gas distribution draft determinations which left stakeholders **feeling that the effort that had been put into developing ambitious proposals which reflected local priorities had been wasted**. Having encouraged engagement **Ofgem ultimately took the view that national standards were more appropriate and that the UIOLI pot should simply be allocated pro rata to customer numbers regardless of the proposals put forward or regional differences in need.** Ofgem has highlighted its desire to ensure that good practice is shared. **It will be important for Ofgem to signal as early as possible the areas where it would like to see common minimum standards. There should be sufficient flexibility to respond to different regional needs and community priorities.**

- On the question of '**no-one left behind**' **we strongly support this as an essential consideration for the energy system transition**. This has been a core focus of much of the work of Sustainability First. One specific manifestation of this could be to ensure that **thought is given to the role that smart electric storage heating can play in the decarbonisation of heat and in the provision of flexibility services to the DNOs, initially perhaps off the gas-grid, but not just.** As set out in the Grid Edge Policy paper on electric storage heating which Sustainability First contributed to[56], electric storage heating tends to be used by those on lower incomes and also is a neglected element of thinking around heat decarbonisation despite its clear benefits as a source of flexibility and as a practical solution for smaller properties that physically could not accommodate a heat pump (or where the upfront costs of a heat pump means it is not cost effective). We would encourage Ofgem to give this as an example of the sort of area where DNO engagement could be beneficial.

[56] '**An Electric Heat Pathway: Looking Beyond Heatpumps'** available here.

- **Ofgem intervention** – Ofgem should send a clear signal that it will intervene to set higher standards for customers where a company's proposed consumer vulnerability strategy is not just out of line with with baseline standards but also out of line with stakeholder expectations and customer and community needs.

- **Removal of SECV[57] –** Sustainability First's 'Energy for All' research found that the stakeholder engagement and consumer vulnerability incentive had "helped to prompt a sea change in activity to engage with and support customers with additional needs." This was very positive. The incentive was however initially designed to catalyse cultural change which now should be embedded (though isn't always). Our research also found that the engagement undertaken was often not strategic, that approaches focussed on 'whizzy initiatives' sometimes at the expense of consistent good practice delivery. In addition, there was no mechanism to ensure schemes which were funded by customers actually then became business as usual (much of which didn't). **We think it's appropriate for the SECV approach to discontinue**. **Innovation funding will continue to be provided under the NIA, which as mentioned below is needed and welcome**. Having a **focus on a Consumer Vulnerability Strategy, will help to take embedding consumer vulnerability within company cultures to the next level, ensuring that consistently good practice and strategic approaches are rewarded rather than just ad-hoc initiatives**. That said, Ofgem may want to consider how it continues to incentivise good quality partnership working in this area as a clear expectation of the vulnerability strategy principles. One approach would be to have a **stakeholder satisfaction measure (as opposed to a customer satisfaction measure)** which looks at the satisfaction of different stakeholder groups working with and on behalf of customers in vulnerable situations.

- **Ofgem 'credibiility' on standards setting –** it will be important for Ofgem to demonstrate that it has engaged with a wide range of consumer vulnerability organisations in setting the ED2 methodology in this area, and beyond 'the usual suspects'. **We would encourage Ofgem to proactively contact organisations that are impacted by the decisions in this area e.g. disability and age organisations in particular who historically may not have been represented in discussions**.

Four other areas on customer vulnerability in the ED2 draft methodology that we welcome are :

- The encouragement that is given to DNOs to develop a **common SROI methodology** (social return on investment) to support reporting in this area. We hope that lessons from this work on electricity distribution can flow through into other sectors and gas distribution in particular. However, SROI should not be used as the basis of calculating CVP rewards.

- The proposal for an overarching **principles-based licence obligation on DNOs to treat their customers fairly**, including those in vulnerable situations, **through-out their operations**. However, this will be meaningless unless it is properly monitored and as mentioned above could be easily supported by a focus on accessibility and broader safety in company consumer vulnerability strategies.

[57] Stakeholder Engagement and Consumer Vulnerability Incentive

- The inclusion in the Network Innovation Allowance of **innovation projects for customers in vulnerable circumstances** and the requirement for all NIA projects to consider any vulnerability impacts. As noted in our Sustainability First 'Energy for All' report, consumer vulnerability innovation can be more complex and riskier than 'standard innovation' and culturally a number of companies have still not properly embedded addressing the needs of all customers into their approaches. **Innovation stimulus is therefore especially valuable and needed.**

- The steps Ofgem has taken to articulate **minimum baseline services** expected by DNOs. This is a positive step. As noted, we would **encourage Ofgem to ensure that a representative range of stakeholders including disability groups have informed these standards**. The challenge will be to keep this knowledge of what is good practice up to date.

In each of these four areas the devil will be in the detail – which it will be important to get right.

OUTQ21: Do you agree with our proposal to use an ex post assessment to penalise/reward companies who fail to deliver their strategies in line with our guidance/exceed performance targets?

Yes. See answer to question 19. The ex-post assessment should help maintain a focus on this important area and will hopefully encourage DNOs to continue to look for new opportunities beyond those identified in business plans.

OUTQ22: Do you consider that an assessment of performance in the middle and at the end of the price control is a proportionate approach?

Yes. See our answers to Qns OUT 19 & 20. We welcome the proposed financial ODI designed to hold DNOs to account on baseline standards and to encourage ambition on their vulnerability strategies. We also support the use of common metrics where possible (for example, following through on DNO work on social return on investment) and the aim for measures of performance which are 'specific, measurable and a clear justification of why they are challenging'[58].

We support the intention of the ex-post assessment, the recognition that some projects may take time to deliver value, and that there may be new issues to address.

In line with good practice we would **expect companies to publish regular updates on their vulnerability strategy** regardless of their reporting requirements to Ofgem. We query whether Ofgem's approach is consistent with the much more regular reporting expectation for suppliers. **As a minimum we would encourage companies to publish an annual report on the accessibility, safety and affordability services they provide to customers**, to show how company practice compares in Ofgem's annual consumer vulnerability report.

It will also be important **after the mid-period and post-review assessments for Ofgem to produce a full report to compare and benchmarks company performance, to highlight lessons learned and examples of good practice**[59].

[58] Annex 1. Paras 6.16-18
[59] See Sustainability First Project Inspire – Energy for All, Innovate for All. Jan 2019.

Maintain a reliable network

OUTQ23: Do you agree with our proposed approach to retain the RIIO-ED1 methodology for setting unplanned interruptions targets?

OUTQ24: Do you have views on the alternative approaches to setting unplanned interruptions targets set out? Are there any other approaches that we have not considered?

OUTQ25: What are your views on revisiting unplanned interruptions targets within the price control period?

OUTQ26: Do you agree with our proposed position not to introduce further convergence of DNOs' targets over time?

OUTQ27: What are your views on retaining an incentive for planned interruptions performance, and the associated targets?

OUTQ28: What are your views on the potential amendments that could be made to the mechanism, including (but not limited to) the options presented in Tables 23 and 24?

OUTQ29: What are your views on how VoLL should be updated for RIIO-ED2?

Over the ED1 period, ENWL has made use of innovation funding for a series of worthwhile studies on the value of lost load (VoLL)[60]. In particular, they commissioned extensive new customer-research by on the potential for greater segmentation in terms of the value that different customer groups place on a secure supply. In turn, this better insight can inform a more nuanced approach than earlier studies to the monetised values attributed to a reliable electricity supply[61]. Taking forward the ENWL customer research, with the help of quantitative specialists, ENWL is now developing a VLL model to support better investment decision-making on different parts of the network, potentially for use by all DNOs [62]. We would hope that this substantial package of work by ENWL on VoLL will usefully inform Ofgem thinking for ED2. It is also relevant to the Engineering Standards Review.

Since ENWL's customer research was concluded in July 2019, the pandemic may have impacted customer thinking on the importance of a reliable electricity supply – especially with respect to communications connectivity. As follow-through to the original ENWL customer research, this should perhaps also be tested for ED2.

OUTQ30: What are your views on the different methodologies for updating VoLL?

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https://www.sustainabilityfirst.org.uk/images/publications/inspire/Energy%20for%20All-%20Innovate%20for%20All%20(full).pdf

[60] July 2019. NIA ENWL010 Value of Lost Load to Customers Closedown report https://www.enwl.co.uk/globalassets/innovation/enwl010-voll/voll-general-docs/enwl010-closedown-report.pdf.

[61] July 2013.
The Value of Lost Load (VoLL) for Electricity in Great Britain Final report for OFGEM and DECC

[62] October 2019
https://www.fnc.co.uk/discover-frazer-nash/news/frazer-nash-supporting-electricity-north-west-with-research-into-new-value-of-lost-load-voll-model/

See OUTQ29 above

OUTQ31: Do you have a view on retaining alignment with VoLL figures used in other RIIO price controls and/or parts of the energy sector?

See OUTQ29 above

OUTQ32: Do you agree with our proposed approach to retain the RIIO-ED1 revenue cap for the IIS at 250 RoRE basis points?

OUTQ33: Do you agree with our proposal not to introduce an incentive on short interruptions in RIIO-ED2? If not, how should such an incentive be structured and developed?

OUTQ34: What are your views on a minimum standard for short interruptions for RIIO-ED2?

OUTQ35: What information should we be capturing in RIIO-ED1 and RIIO-ED2 to better understand short interruptions and how DNOs are performing?

OUTQ36: Do you agree with our proposal to retain the RIIO-ED1 SWEE mechanism?

OUTQ37: Do you agree with our proposal to remove the OEE mechanism? If not, what evidence is there to support its retention, and what changes should be made to the existing approach to improve it?

OUTQ38: What are your views on the threshold that should apply to either exceptional event mechanism?

OUTQ39: What performance do you think should be excluded under each mechanism?

OUTQ40: Do you agree with our proposal to retain the existing GSoPs? If not, what changes do you think are necessary and what are the reasons for them?

OUTQ41: Do you agree with our proposal to uplift payment values in line with inflation, indexing payment levels to inflation, and rounding to the nearest £5 for clarity for stakeholders?

OUTQ42: Do you agree with our proposal to retain some form of mechanism for WSC in RIIO-ED2?

OUTQ43: What are your views on the options presented for WSC? Are there other options that we should consider?

Maintain a safe and resilient network

OUTQ44: Do you have any views on our proposed NARM framework?

OUTQ45: Do you agree with our proposal not to introduce outputs or incentives related to workforce resilience?

OUTQ46: Do you agree with our proposal that DNOs should submit a Cyber Resilience IT Plan and a Cyber Resilience OT plan?

OUTQ47: Are there further requirements of expectations that we should be considering for the DNOs?

OUTQ48: Do you agree with our proposal for the establishment of a 'climate resilience' taskforce or working group, to help DNOs develop strategies for managing the risks of climate change?

We were pleased to see acknowledgment of the need for a focus on climate adaptation (which was missing in Draft Determinations). A taskforce seems a sensible first step and could be extended to the other networks.

OUTQ49: How should DNO strategies inform best practice that is used across the industry? How can these be used to help DNOs develop longer term investment proposals to manage the risks of climate change?

OUTQ50: Do you agree with our proposal to retain the RIIO-ED1 approach to flood resilience?

OUTQ51: What are your views on how we/industry reports on progress against flood resilience plans?

OUTQ52: Do you agree with our proposal to retain the RIIO-ED1 approach to ensuring networks are resilient to trees?

OUTQ53: Do you agree with our proposal to develop a wider resilience measure over the course of RIIO-ED2? If so, what should it cover?

OUTQ54: Do you agree with our proposed approach of retaining the existing arrangements for Black Start, physical security, and telecommunications resilience?

OUTQ55: Do you agree with our proposal to include a reopener for physical site security, with a window during the price control and a window at the end of the price control?

OUTQ56: Do you agree with our proposal to continue monitoring the development of telecommunications resilience and reviewing the arrangements as necessary?

Delivering an environmentally sustainable network

OUTQ57: Do you think our proposed environmental framework will drive DNOs to deliver an environmentally sustainable network?

The draft ED2 methodology introduces a new environmental framework for the companies with a clearer expectation than for ED1 on **common methodologies and more consistent environmental reporting against long-run targets**. Over time, the requirement for an EAP and clearer annual reporting (via the AER) will allow the companies, the ENA, Ofgem and wider stakeholders to build a better-informed and more accurate environmental picture – including cross-sector and cross-vector. This is very welcome.

However, **across key environmental outcomes**, the draft ED2 methodology proposes **only relatively weak reputational output incentives** (for AER reporting, for losses, for SF6 leakage). In some instances, these incentives are actually weaker than in ED1. We question how far the proposed set of reputational incentives will successfully deliver an environmentally sustainable network.

By contrast, for some other key ED2 areas a **new mechanism** is proposed that requires the companies to develop and deliver against strategies - **strategy delivery incentives** (for DSO, large connections and vulnerability). This is welcome. These strategies must **meet Ofgem minimum requirements but also crucially include a financial incentive to ensure that the companies deliver against their strategies and are motivated to go further.** These strategy delivery incentives will be assessed by Ofgem mid-period plus at the end of the price control, taking account of performance against pre-defined metrics but not purely mechanistically. **This seems to provide an appropriate balance of a quantitative and qualitative incentive in what are complex areas.** We should like to see an equivalent **'strategy delivery incentive' adopted to drive environmental progress, in particular for decarbonisation and net-zero – and we would urge Ofgem to consider adopting a Strategy Delivery Incentive.** This could bring together a cross-cutting incentive mix : clear minimum standards, a mechanism to ensure companies deliver on commitments, financial incentives with some metrics to stretch performance, plus reputational incentives where environmental outputs are not yet readily measured. **A strategy delivery incentive for an environmentally sustainable network would allow Ofgem to send a stronger and more concerted signal to the companies on the value of decarbonisation and net-zero to consumers and future consumers**.

The draft ED2 methodology indicates that Ofgem is open to evidence on how financial incentives for environmental outputs could drive additional value for consumers in a manner which is measurable and does not create perverse incentives on companies. We note that for NGGT and NGET Ofgem is proposing to accept a financial incentive based on a scorecard of EAP metrics. In its decision Ofgem said "*we consider that an ODI-F would ensure NGET has a financial interest, proportionate with its involvement and effort, in achieving or exceeding the RIIO-2 targets set out in its EAP*". This summarises well the rationale for a financial incentive in this area. Ofgem has put careful thought into the design of the NGGT/NGET incentive to weight the different metrics appropriately. While this EAP scorecard feels to us less flexible than an in-the-round 'strategy delivery' approach, it demonstrates that quantification is possible and may provide a useful starting point for a broader strategy delivery incentive.

OUTQ58: Do you consider that the proposed areas in scope of the Environmental Action Plan, and associated baseline standards, are appropriate? We particularly welcome views on any areas that should be omitted/included and if new areas should be included, what the baseline standard should be?

We note the proposed split in scope of the Environmental Action Plan (EAP) between **'decarbonise the networks'**[63] and **'reduce the wider environmental impact of network activity'**[64], which is a helpful distinction. We also note that the proposed baseline standards for each area reflect rather mixed ambition-levels and these continue to be debated in Ofgem's ED2 Decarbonisation and Environment Working Group[65]. Since initial design of ED1 incentives over six years ago, new net-zero requirements have fundamentally changed the picture. We have a real practical concern that Ofgem's approach in ED2 to the environmental baseline standards for decarbonisation **is largely incremental rather than a 'step-up'.**

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[63] Decarbonise the networks : BCF, Losses, SF6, Embodied carbon (Annex 1. Table 41. P 141. Proposed Scope of the EAP)

[64] Reduce the wider environmental impact of network activity **:** supply chain management, resource use and waste, bio-diversity & natural capital, fluid filled cables, noise, NOX & air quality

[65] Annex 1. Table 42 para 9.16, p 143 & Appendix 8 (p 189)..

Company commitments on baseline standards – made via Environmental Action Plans – will be reflected in business plan base-line funding bids. Stronger environmental ambitions should reflect in good outcomes for companies from the consumer value proposition in the business plan incentive.

However, progress on those commitments during the price control period - reported via Annual Environmental Reports (AERs) - will **depend for delivery largely on a reputational incentive** - **unless treated as PCDs**[66]. If faced with a tight price control, companies will look to make savings where they can. While many have a strong corporate commitment to a sustainability agenda, this may come under pressure should investors face lower returns. We can already see this in water. **A reliance on reputational incentives alone is therefore not adequate for this critical area.** While PCDs may help on non-delivery, on their own they do not provide a sufficient incentive on companies to continue to look for opportunities **to go further in the price control period - which a financial incentive as part of a strategic delivery incentive would do -** and as outlined in our response to questions 56 & 57.

On **business carbon footprint** and the EAP, **Ofgem's position on science-based targets needs to be clarified**. Ofgem indicates that companies should sign up to these - described as targets that are consistent with the Paris agreement[67] and net zero obligations in the long-term[68]. In practice, the science has continued to develop since the Paris agreement in 2015 and the leading organisation in this area now encourages companies[69] to sign up to targets that are consistent with a 1.5 degree temperature increase. Importantly for ED2 this is also consistent with the UK's 2050 statutory position on net zero. Ofgem should therefore recognise this and clarify that **DNOs should adopt science-based targets for their own emissions which align with 1.5 degrees**. Although perhaps implicit, there would also be merit in making clear that the definitions on the scope of the emissions to be included in these targets should be consistent with the global Greenhouse Gas Protocol and the science-based targets initiative. Specifically, as we read it, this means that technical losses on the distribution network should be included in Scope 2.

On **SF6** while we recognise that leakage is much greater on transmission, this remains a highly potent greenhouse gas with a global warming potential ~23,000 times that of CO2. **Having developed a financial incentive for SF6 leakage for ET we would expect the same incentive to be applied in ED to SF6 leakage** – the value of savings in SF6 emissions from either sector should in principle be the same. For distribution, plans for SF6 containment and eventual safe disposal should be a priority. For distribution, SF6 is spread in far smaller volumes across a great many more individual items of equipment. Unless there is a real risk of leakage, to accelerate replacement before the end of asset-life would be costly and arguably of low consumer and emissions benefit[70]. As a minimum however there should be an **expectation on DNOs to work collaboratively**, **including with transmission and the supply chain**, to develop **a network-wide strategy and plan into RIIO3 for safely reducing SF6 holdings over the long-run.** This should then form part of whatever wider financial incentive is put in place for environmental performance.

We also note that in terms of **the cost of carbon** there is a consistency issue on what Ofgem expects companies to use for their investment appraisals - and hence inform their decisions on losses or SF6.

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[66] Price-Control Deliverables – and which in general they were not in the T/GD draft determinations on materiality grounds

[67] Annex 1. Footnote 117. P 143

[68] Annex 1. Para 9.12. p 142

[69] https://sciencebasedtargets.org/step-by-step-guide/

[70] albeit new environmental regulations on SF6 phase-out would change the picture

To date, the guidance to companies has been to use HMT assumptions. However, Ofgem's own IA guidance talks about carrying out sensitivity assessments at the high-end of the HMT range. This is because HMT figures have not yet been updated for net zero. We ask Ofgem to ensure that the cost of carbon figure which the DNOs are expected to use in their cost-assessments is transparent and consistent with net-zero.

Last, **the DSO role and remit** and how this is to be incentivised will be absolutely central to successful long-run company approaches and outcomes to emissions reduction and net-zero. Many others have a strong interest in the DSO role, and we do not propose to comment in detail here. However, we have a particular concern that **the draft ED2 methodology is silent on the DSO role in terms of both approaches to decarbonisation and also to net-zero**. In the DSO principles, the sole reference to carbon relates to providing information, inter al, on the carbon content of plant despatched for ancillary services. There seems to be a very strong case for **the DSO to have a specific 'net-zero' duty right across its role** – with respect to network investment decisions, connections, operations, despatch and market development. This would sit well as a part of our proposed 'strategy delivery incentive' approach to incentivising DNO decarbonisation and net-zero (our response to OVQ23 also refers).

OUTQ59: Do you agree that the annual reporting through the Environmental Impact Report will increase transparency of the DNOs' activities and the resulting impacts on the environment?

Environmental impact reports are an ED1 licence obligation, but have not been produced on a consistent or comparable basis.

As noted in OUTQ56, the requirement for clearer annual reporting in ED2 via the Annual Environmental Report (AER) will allow the companies, the ENA, Ofgem, and wider stakeholders to build a better-informed and more accurate environmental picture – including cross-sector and cross-vector. The AER reports are an essential building block in gaining clearer understanding of what additional actions may be needed in the networks to make timely progress towards net-zero. **Ofgem must also consider its own role in consolidated annual reporting.**

However, as noted in our responses above to questions OUT57-58, we have considerable doubts that the proposed EAP & AER framework incentive proposals – in particular with respect to decarbonisation and expectations on BCF targets – can be relied on to drive the required environmental outcomes and impacts towards net-zero.

OUTQ60: Do you agree with our proposal to introduce a re-opener to accommodate environmental legislative change within the RIIO-ED2 period?

We agree, but any such re-opener must be tightly drawn, including on materiality, and clearly delineated from the net-zero reopener[71]. In ED2 its most likely use might be associated with

[71] Annex 2. Para 11.23. p 94
Purpose : A re-opener to recover costs associated with compliance with environmental legislation
Benefits : To ensure that DNOs are funded efficiently in line with changes to environmental policy and legislation

legislation to phase-out SF6. Or perhaps less likely, a future change to current thresholds for eliminating PCBs in small pole-mounted transformers.

OUTQ61: Do you agree with our proposed removal of the Losses Discretionary Reward?

We recognise that losses are a complex area but are very concerned that Ofgem seem to be going backwards compared to ED1.

We do not agree that losses should be incentivised by a reputational incentive only. See our answer above to OUTQ57 on the need for a decarbonisation strategy delivery incentive which would incorporate a financial incentive, including with respect to losses.

The ENA has overseen a review of losses treatment[72] – and has put forward a proposal for a losses reputational incentive with life-cycle CBA, which Ofgem seems inclined to adopt (albeit how CBA outcomes on losses will be factored into investment plans is still being discussed). However we do not consider that provides a strong enough incentive on companies to address losses. The use of CBA in developing investment proposals for the business case makes sense but there needs to be a clear mechanism to ensure that companies do not ultimately decide to make efficiency savings by using cheaper (high loss) equipment. We note that design of the incentive is company-led and that the interests of companies and consumers in the area of losses may not necessarily be fully aligned. .

In the decision on Tranche 3 of the Losses Discretionary Reward Ofgem highlighted the importance of tackling losses. It is therefore of note that Ofgem concluded that none of the companies were doing enough in this space to merit a reward (despite £14 million being available). In this context it is hard to see how a purely reputational incentive can be expected to deliver an adequate response by the companies.

I**n the absence of any meaningful alternative we disagree strongly with Ofgem's proposal to drop the ED1 Losses Discretionary Reward** (which Ofgem describe as a reputational incentive – but has a clear financial dimension).

In the long term – once the grid is fully decarbonised – the association of losses with carbon emissions will cease. However, at around 95% today of all DNO Scope 1 and 2 emissions, losses will remain the dominant source of carbon emissions associated with DNO operations in ED2. For the long-term losses will also remain a very significant efficiency issue. Currently losses account for 6-7% of all energy generated and the ENA report suggests this could increase by 350% with the rise in LCTs. Meeting the electricity capacity requirements for electrification of heat and transport will be all the more challenging and expensive if such a significant% portion of the renewable energy generated continues to be lost through distribution losses.

Losses will increase with new network investment, more renewables and also operating networks nearer their physical limits. Ofgem has said it does not want to favour one output over another.

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[72] WSP report for ENA. September 2019

CEP023 TECHNICAL LOSSES MECHANISM STUDY Development of a Losses Incentive Mechanism: Phase 1 Final Report
https://www.energynetworks.org/assets/files/CEP023%20Technical%20Losses%20Mechanism%20Study%20Final%20Report.pdf

However the ED2 proposals risk doing just that by putting a financial incentive on connection of LCTs or on utilisation - but not at the same time on loss reduction. The networks need to be incentivised to balance these considerations appropriately throughout the price control period. While Ofgem has signalled that it will allow the costs of low-loss equipment in baseline allowances (where the case is made), as it stands, there is nothing to stop companies ultimately opting for cheaper equipment in a quest for efficiency savings. The merit of the Losses Discretionary Reward (or an updated version – as part of a new decarbonisation strategy delivery incentive as proposed above) is that this would provide the flexibility to cope with the complexity inherent in losses while retaining a focus on losses through a strong (ie financial) output incentive for the companies to identify controllable losses and do more to manage them.

More focus also needs to be put on the measurement of losses which has historically been challenging but with the advent of smart meters and other monitoring equipment it should be possible to do a much better job. Improved measurement is one element of the Losses Discretionary Reward that has not been addressed in the ENA proposals.

OUTQ62: Do you agree with our proposal to retain the visual impact allowance for RIIO-ED2?

Yes[73]. We note that Ofgem feels that the scheme has worked well and flexibly in ED1.

We would expect Ofgem to engage directly with relevant statutory and non-statutory bodies (including those which are representative of interests beyond National Parks and AONBs) to understand their thinking on the merits of rolling forward the scheme 'as is'.

OUTQ63: Do you agree with our proposed approach to setting a funding pot for the visual impact allowance for RIIO-ED2?

We note that Ofgem does not propose to set PCDs for project outputs in ED2, but will request DNOs to indicate in their Business Plans the likely value of ED2 under-grounding projects they could deliver. This seems important, as so far only around one-fifth of the total available allowance has been spent. A use-it-or-lose it arrangement as now seems well suited to this area.

On WTP, it is noted that the last distribution-level WTP research on undergrounding was some time back (DCPR5). Ofgem indicate they may use the ET2 WTP research from NERA to inform its decision. We would encourage Ofgem to seek the views of the statutory and non-statutory environment bodies on how far they would regard transmission WTP research as relevant.

[73] Annex 1. Pp 151-154

Ofgem Annex 2: Keeping bills low for consumers

Approach to Aggregated Econometric Analysis

COQ1: Do you agree with our proposal to include totex benchmarking in our toolbox for cost assessment in RIIO-ED2?

COQ2: What cost drivers do you consider appropriate for our proposed totex benchmarking? Why?

COQ3: What are your views on the use of both historical and forecast data in our modelling?

COQ4: At what level should we set the efficiency benchmark?

COQ5: Do you agree with the proposed criteria for developing cost pools for a middle-up approach?

COQ6: What cost drivers would be appropriate in a middle-up approach?

COQ7: What are your views on the CEPA developed totex and opex plus approach? What opex activities are there trade-offs that support the rationale for testing 'totex and opex plus' modelling?

COQ8: Do you believe it is appropriate to use bottom-up, activity-level, disaggregated modelling in RIIO-ED2?

COQ9: If we use a combination of aggregated and disaggregated modelling approaches, how should we determine the weight we apply to each, in combining our analysis?

COQ10: If we did not use disaggregated modelling approaches, what approach should we consider for disaggregating totex allowances for the setting of PCDs?

Model Specification

COQ11: What model estimation options should be considered for our cost assessment and why?

COQ12: Do you agree with our proposal to continue using Cobb-Douglas functional form? Why?

COQ13: Do you have any views on our proposed model selection criteria?

Regional and Company Specific Factors

COQ14: Do you agree with the proposed criteria for assessing regional and company specific cost factors that we have outlined?

COQ15: What are your views on our approaches to account for regional and company specific cost factors in our modelling?

Real Price Effects and Ongoing Efficiency

COQ16: Do you agree with our proposed approach to index RPEs, rather than setting an ex-ante allowance based on forecasts?

COQ17: Do you agree with our proposal to have a high materiality threshold for RPEs? What are your views on the materiality level for RPE submissions, and the criteria we use to select input price indices?

COQ18: Do you agree with the suggested common input and expenditure categories for structuring RPEs in ED2?

COQ19: Do you agree with our proposed approach, and its scope, to set an ongoing efficiency assumption for RIIO-ED2?

COQ20: Do you agree with our proposal to use a growth accounting approach as our primary source of evidence to set an ongoing efficiency assumption? What parameters would best support this approach?

Disaggregated Cost Assessment

COQ21: Do you agree with our proposed approach on forecasting options for RIIO-ED2

COQ22: What are your views on our proposal for establishing network impacts and assessing LRE requirements for RIIO-ED2?

COQ23: Do you agree with our proposal to compare flexibility solutions and network based solutions evenly in our cost assessment?

COQ24: How should we treat the fixed costs of procuring flexibility when considering flexibility solutions as an alternative to reinforcement?

The cost of carbon needs to be consistently and appropriately valued for net-zero across all ED2 cost assessments, including cost-assessments for flexibility. Ofgem must provide guidance to the companies to use a value for the cost-of-carbon which aligns with Ofgem's own approach in its impact assessments ie HMT Green Book 'high-case' – until such time as HMT updates green-book guidance to align with net-zero.

Thought also needs to be given as to how to compare the option value inherent in flexibility solutions compared to 'irreversible" reinforcement'. The thinking presented by Goran Strbac at the OAWG is an important contribution in this space and needs further consideration.

In addition, under **uncertain conditions** CBA distributions may be skewed - with the potential for low probability high impact events possibly more frequent than assumed in CBA tools based on a normal distribution[74]. There are also some basic questions on choice of an appropriate discount rate for assessing intergenerational benefits[75].

COQ25: What are you views on the use of LIs as outputs in RIIO-ED2?

COQ26: What are you views on the treatment of incremental costs in RIIO-ED2?

COQ27: Do you agree with our proposal to maintain the RIIO-ED1 approach to assessing Non-op capex costs in RIIO-ED2?

COQ28: Do you agree with our proposal to maintain the RIIO-ED1 approach to assessing NLRE in RIIO-ED2?

COQ29: Do you agree with our proposal to maintain the RIIO-ED1 approach to assessing NOCs in RIIO-ED2?

COQ30: Do you agree with our proposal to maintain the RIIO-ED1 approach for assessing CAIs in RIIO-ED2?

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[74] Monte Carlo analysis ; P50/P90.

[75] For example a discount rate of 3.5% real for inter-generational benefits makes little sense (e.g. as argued by Stern) – especially when the real-cost of debt is also factored-in, currently already well below this.

COQ31: What are your views on the different approaches presented for the treatment of BSCs in RIIO-ED2?

Cost Benefit Analysis
COQ32: Do you agree with our proposed application of CBA in the appraisal of investment options for RIIO-ED2?

The cost of carbon needs to be consistently and appropriately valued for net-zero across all ED2 cost assessments. Ofgem must provide guidance to the companies to use a value for the cost-of-carbon which aligns with Ofgem's own approach in its impact assessments ie HMT Green Book 'high-case' – until such time as HMT updates green-book guidance to align with net-zero.

Engineering Justification Papers
COQ33: Do agree with our proposals to retain the requirement for DNOs to produce Engineering Justification Papers?

COQ34: Do agree with our proposal retain the assessment framework for EJPS developed as part of the RIIO2 process?

COQ35: Do agree with our proposal to adopt the principals outlined above to guide the production of EJPS and focus the engineering submission?

Data Assurance and Compliance
COQ36: What specific activities and methods should be adopted to ensure the Data, Data Assurance and Compliance processes of the RIIO-ED2 price control are run as effectively as possible?

Uncertainty Mechanisms
COQ37: Do you agree with our proposed uncertainty mechanisms and their design?

Annex 2. Table 7 para 11.11 p. 89 summarises Ofgem's proposed approach to uncertainty mechanisms in ED2.

See our response on a net-zero reopener (OVQ3) and on an environmental re-opener (OUTQ60).

For uncertainty mechanisms for strategic investment (Overview Doc, Appendix 3) , see our response to OVQ9 – and our response to COQ38 below.

COQ38: Are there any other uncertainty mechanisms that we should consider? If so, how should these be designed?

See our response to OVQ9 and COQ39 below. To support a moderately good future line-of-sight for the companies on baseline allowances, a good deal of thought is yet needed on design of uncertainty mechanisms which are sufficiently robust (i.e be these a PCD with a funding trigger in a regional plan, or capacity-based volume drivers)[76].

[76] Appendix 3. A3.2 p 82. Uncertainty Mechanisms. Presented as either (1) a PCD with funding triggers based on a regional plan (eg award of government funding, phase out of gas boilers) or (2) Volume Drivers – LCT volume driver, or, Capacity volume driver.

COQ39: Do you agree with our proposed removal of the above uncertainty mechanisms for RIIO-ED2?

We agree that correct design of uncertainty mechanisms for strategic investment should, in principle, allow for removal of the ED1 re-opener for Load Related Expenditure. However, before finally committing to remove this, Ofgem will need to be satisfied as to the robustness of the alternatives for ED2.

COQ40: Do you agree with our proposed common approach for re-openers being applied to RIIO-ED2?

Distribution investment has different basic characteristics from transmission investment - in scale and potential volume. There may therefore need to be a separate 'common approach' to re-openers for strategic investment for distribution uncertainty mechanisms.

Increasing Competition
COQ41: Do you agree that our flexibility proposals are sufficient to incentivise DNOs' native competition?

COQ42: Do you believe there are similarities between DNOs running early competitions and the roles and activities that may be related to electricity DSO functions?

COQ43: Do you agree with our proposed approach on early competition?

COQ44: Do you have any views on our draft RIIO-ED2 Late Competition Impact Assessment?

COQ45: What are your initial views on the three models of late competition (CATO/CADO, SPV and CPM) in the context of electricity distribution? If there would need to be differences from the other sectors, can you please explain what these should be, and why.

COQ46: Do you agree that the late competition models proposed could deliver benefits in RIIO-ED2?

COQ47: Do you agree that our proposed criteria for identifying projects suitable for late model competition are applicable in the context of electricity distribution?

COQ48: What are your views on the best ways to identify a suitable project pipeline for late competition in electricity distribution (eg our proposal to require flagging of projects that meet the high-value, new, and separable criteria)?

COQ49: Do you agree with the proposed range of options available for repackaging projects in RIIO-ED2 in order to maximise consumer benefit?

COQ50: What relevant factors do you think we should consider in deciding how these repackaging proposals are specifically applied in electricity distribution?

Incentivising Business Plans and their Delivery
COQ51: Do you agree with our proposed approach to implementing the CDIR method in setting the TIM efficiency incentive rate?

COQ52: Do you agree with our proposed design of the BPI for RIIO-ED2?

We agree that more focus should be given to the Consumer Value Proposition element of the BP. We agree that it is helpful to specify in advance the areas within which proposals should fall and by using information revealed through the CVP to set higher baseline standards for the whole sector in certain key areas (para 13.19). This in turn should be subject to suitable testing with the companies and stakeholders.

If the aim is to drive *wider ambition* across all of the companies and to be used as the basis for improved baseline standards, then we **agree** (para 13.29) **that the CVPs should be assessed following the draft business plan submission (1 July 2021).** This will at least allow some time for companies to engage and reflect the higher standards in their Plans (or explain why they would not be appropriate).

We agree with the five topic areas listed for CVPs (para 13.27 - DSO, Customers in Vulnerable Situations, Large Connections, EAP baseline standards, whole systems). **To this list we would also add approaches to the quality and timely preparation of decentralised forecasts, scenarios and D-FES to ensure common and consistent approaches.**

We would encourage Ofgem to look in the round at the level of ambition that companies demonstrate in these areas rather than just looking for individual eye-catching initiatives.

In addition, approaches to stakeholder engagement in developing business plans should be assessed as part of the BPI/CVP at the draft business plan stage - with a benchmarking report on the quality of engagement published as a part of Ofgem's CVP assessment process.

COQ53: What are your views on our suggestion to use proposals contained in draft business plans in the setting of baseline standards in a number of areas (as discussed in paragraphs 13.28 and 13.29)?

See our answer to COQ52 above.

COQ54: Do you agree with our proposal to cap the number and value of CVP proposals that can be included within business plans

It makes sense to focus on five or six categories for the CVP. It is not clear on what basis Ofgem considers that there should be a maximum of ten proposals per business plan, nor why the aggregate pot of £50m is appropriate (given that ED2 incentives in other areas may be set as at much as 1% of annual revenues).

COQ55: Is there any further detail on the proposed content of the Business Plans that you think should be set out in the Business Plan Guidance?

DSO principles and baseline standards should include a reference to having regard to net-zero and decarbonisation outcomes across DSO planning, operation, despatch and market development.

COQ56: Is there other information that we should be requesting in the Business Plan Guidance in order to assess a network company's Business Plan?

COQ57: Do you agree with the proposed set of minimum requirements for Stage 1 of the BPI that are set out in the draft Business Plan Guidance?

COQ58: Do you agree with the approach for assessing companies CVP proposals that is set out in the draft Business Plan Guidance?

See our answer to COQ52 above.

In particular, approaches to stakeholder engagement in developing business plans should be assessed as part of the BPI/CVP - with a benchmarking report on the quality of engagement produced as a part of Ofgem's CVP assessment process

COQ59: We anticipate that DNOs are investing in improving / creating data dictionaries and business information models that describe the data-driven aspects of DNOs overall business architecture. We anticipate there may be opportunities to take advantage of these investments to support the process of cross-referencing data used within RIIO-ED2 Business Plans. What are your views on this?

This would be helpful.

Annex 3: Finance

Allowed return on debt

FQ1: Do you agree with our proposal to use the iBoxx Utilities 10yr+ index rather than the indices used in RIIO-1?

FQ2: With reference to paragraph 2.8, do you have a view on what debt allowance calibration should be used for business plan working assumption purposes, and why?

FQ3: Do you have any evidence to suggest ED networks should or should not have a debt allowance that has a different calibration to GD&T networks?

FQ4: Do you have any views on our analysis of additional costs of borrowing that may not be captured by an index of bond yields?

FQ5 : Do you agree with our proposal to use the longest term OBR forecast for CPI to deflate nominal index yields to a real CPIH allowance and to switch to using OBR CPIH forecasts if these become available?

Allowed return on equity

FQ6: In light of the equity methodology we set out in Draft Determinations for GD&T, do you have a view on how implementation could best be applied to the ED sector?

FQ7: Do you have suggestions on how we could estimate systematic risk for ED2 or any evidence to support a difference between ED and the other RIIO sectors, GD&T?

Financeability

FQ8: Do you agree with our proposal to align the RIIO-ED2 financeability approach with the approach we have taken for GD&T?

FQ9: Are there any reasons why this approach should differ for RIIO-ED2?

FQ10: Do you have a view, supported by evidence, regarding the appropriateness of different measures to address any financeability constraints?

FQ11: Do you have any views on the proposed scenarios to be run for stress testing?

Financial resilience
FQ12: Do you agree with our proposal to place additional requirements on licensees in RIIO-ED2 to provide Ofgem with a) published ratings reports, and b) a financial resilience report if their issuer credit rating falls below specified levels?

Corporation tax
FQ13: Do you agree with our proposal to align the RIIO-ED2 tax approach with RIIO GD&T including; to pursue Option A; the approach to additional protections; the approach to capital allowances; and not to pursue the Fair Tax Mark certification as a requirement for RIIO-2?

FQ14: Are there any reasons why this approach should differ for RIIO-ED2?

Indexation of the RAV and allowed return
FQ15: Do you agree with our proposal to implement CPIH inflation?

FQ16: Are there any reasons why this approach should differ for RIIO-ED2?

Regulatory depreciation
FQ17: Do you have any specific views or evidence relating to useful economic lives of ED network assets that may impact the assessment of appropriate depreciation rates?

FQ18: During RIIO-ED1, the assumed asset life is being increased. Do you consider another change is required in RIIO-ED2 to reflect the expected economic asset life? If so, do you have supporting evidence and proposals, at this stage?

Capitalisation rate
FQ19: Do stakeholders support licensee specific rates for the ED sector?

FQ20: For one or more aggregations of totex, should we update rates ex-post to reflect reported outturn proportions for capex and opex?

Directly remunerated services
FQ21: Are there any reasons why the RIIO-ED2 approach to directly remunerated services should differ from RIIO-ED1?

Disposal of assets
FQ22: Do you support our proposal to continue the RIIO-ED1 approach to disposal of assets for RIIO-ED2?

Dividend policy
FQ23: Do you agree that additional reporting on executive pay/remuneration and dividend policies will help to improve the legitimacy and transparency of a company's performance under the price control?

Yes. Improved governance, legitimacy and transparency is extremely important for utilities funded with private capital to provide essential GB services. Sustainability First has been leading a three year multi-partner project of which Ofgem is a co-sponsor on the purpose agenda for utilities – **Fair for**

the Future. As a part of the project we have just published a major How-To Guide on a sustainable licence to operate for the utilities[77].

Return adjustment mechanism
FQ24: Do you agree with our proposal to introduce a symmetrical RAMs mechanism?

FQ25: Do you agree with our proposal to introduce a single RAM threshold level of 300 basis points either side of the baseline allowed return on equity?

FQ26: Do you have any other comments on our proposals for RAMs in RIIO-ED2?

Sustainability First
25 September 2020

[77] https://www.sustainabilityfirst.org.uk/fair-for-the-future
Sustainability First. Developing and Embedding a Sustainable Licence to Operate and a Purposeful Business Approach. A How-To Guide for Public Utilities. September 2020
https://www.sustainabilityfirst.org.uk/images/publications/fair_for_the_future/Fair_for_the_Future_Project._How_2_Guide_FINAL1.pdf