

Ofgem RIIO-ED2

Methodology consultation

Annex 2 Section

Citizens Advice submission
October 2020

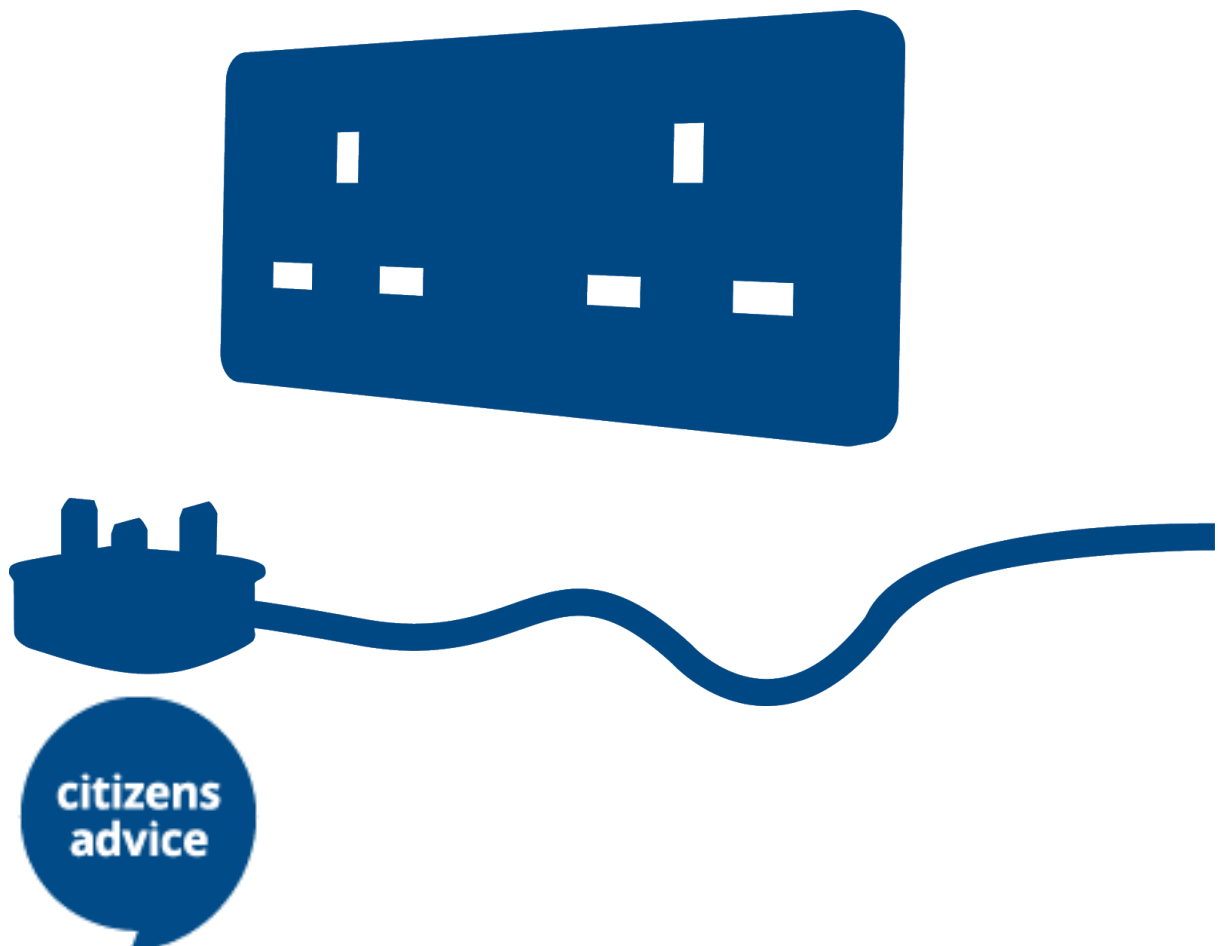


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This is the third of 4 submissions in response to the RIIO-ED2 Sector Specific Methodology consultation. Please read our first response which contains our Executive Summary as this provides context to the responses in this section.

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?

We think top-down totex modelling provides a simple comparative analysis between DNOs which we appreciate offers operational practicalities for Ofgem and aggregate narrative for network costs. However, in order to incentivise network investment in ED2 that reduces overall costs, while being fair to all consumers, we would encourage Ofgem to consider where possible more disaggregated middle-up benchmarking. We believe that ED2, more than other price controls, except perhaps the ESO, requires more weight given to exogenous cost drivers and scrutiny of networks anticipation of demand. This should incentivise better forecasting and support for new sources of demand in transport and heat and respond to more renewable energy being produced locally.

In the interests of consumers, the ED2 approach should offer the most cost efficient investment approach by ensuring all DNOs offer efficiencies relative to their respective network forecasts. This approach is clearly dependent on strong Business Plan Incentives to ensure that networks accurately factor in the development of exogenous cost drivers, local needs and fixed external costs in a consistent format. This should help Ofgem to set the totex for each network's pool of expenditure.

ED2 pools of expenditure should reflect the increasing range of options at a network's disposal to manage load. The maximum load utilisation of an asset or network intervention, alongside how it meets other output criteria that provide distributional fairness, can increasingly only be determined by a network through effective forecasting of multiple cost drivers, output requirements and considering the price control implications of that asset.

We encourage Ofgem to take an approach to totex that includes strategic asset utilisation criteria for broadly linked pools of network expenditure, including prospective efficiencies. That's because a top-down totex approach to a network efficiency will be highly dependent on the conventional energy network asset balance. The evidence available to support this model is based on legacy requirements and legacy incentives, or updated through a top-down aggregate view of change. Legacy evidence will encourage traditional forms of network reinforcement and development and an updated aggregate view on asset profile change will not allow networks to best meet the ongoing local needs of consumers.

We think that Ofgem should be weighing the evidence of past and current evidence of networks planning and forecasting to determine the extent that

network claims about exogenous factors causing deviation from a standard asset type benefit realisation.

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

As network asset choice becomes more varied and network decision making becomes more subjective to meet specific and nuanced local needs, cost drivers are both universal for all networks but are likely to require more tailored weighting for each network. This means that the totex cost drivers cannot be as consistent across the price control or meet the criteria that Ofgem set. These are:

- Make economic and/or engineering sense.
- Be accurately and consistently measurable.
- Have a relatively stable relationship with the costs over time and incorporate as much relevant information as possible.
- Be beyond the control of the network company.

Specifically, the relatively stable costs will be progressively less feasible as the speed of LCT uptake and consumer engagement with their use increases. Then when assessing whether drivers make economic or engineering sense will be a partially subjective network decision based on the context in which assets are used. But finally and most difficult to address via a top down totex cost driver is to be beyond control of the network company. The strategic decisions and technology choices a network business makes will not leave them equal to future cost drivers. The way in which a network invests in a network will determine their future exposure to cost drivers. As a result, it is important that a network's consideration of its output benefit for consumers must factor in their long term exposure to uncontrolled cost drivers.

As outlined in COQ1, strategic asset utilisation criteria for broad pools of network assets should allow a range of cost drivers to be identified and weighed by networks. It is then up to Ofgem to determine the extent to which they accept the justifications and implications of the weighting provided.

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

As outlined in COQ1 we have concerns about an over reliance on historical data and any simplistic industry wide correction to historical data. As outlined in OVQ4 we think that forecasting quality and standardisation needs to be directed

by Ofgem to significantly improve for ED2 to enable Ofgem to take a meaningful view of strategic investment and regional variation in network decisions.

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

No response provided.

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

We think the proposed approaches are good methods of defining the broad pools of assets and the interlinked dependencies. We think further categories for highly anticipatory investments and for assets that contribute to the delivery of a specific local energy target.

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

Where the operational delivery allows Ofgem, we encourage the use of the middle-up approach for all cost drivers used for totex or where disaggregated costs can be effectively pooled.

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?

Alongside the middle-up approach, the 'totex and opex plus' modelling is another compromise between top down and bottom up totex. We think that this is broadly a desirable approach to take for the reasons outlined in COQ1-6. However, we think that a more detailed and responsive Middle-up approach can be used to better encourage network ownership of strategic investment choices, while 'totex and opex plus' provides a mechanism focused on offering network flexibility through consideration of where, specifically, pooled opex and other costs have immediate complementarities and trade-offs.

We support further work in this area to encourage the evolving modelling of these approaches given their potential to aggregate the implications of asset classes and to encourage broader considerations of their implications in a holistic and impartial way. We think that they will be a step towards delivering price control designs that define appropriate strategic investment honed to best deliver consumer outcomes. As more standardised and insightful data is used in network planning and forecasting - Ofgem should place more emphasis on

modelling aggregate costs that reflect the strategic choices networks take and provide justification for varying network benchmarks.

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

In our view the use of a holistic middle-up modelling should provide an aggregated view of network options. While some costs are largely fixed and can be disaggregated with an exact and replicable figure across networks other costs from ED1 are likely to vary more by network.

Disaggregated modelling provides an important level of detail for accurately determining totex. However, by increasingly giving greater weight to a Middle-up approach it will incentivise strategic considerations in the allocation and decision on variable costs. This will incentivise networks to consider the impact of interventions holistically to explain and justify decision making through aggregate narratives about delivery which better explain and justify decision making. Ofgem's overview of network proposals should benchmark these proposals against a view of totex value realisation from expenditure for the identified expenditure groupings.

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?

Given a new approach is likely to be required for top-down/middle-up totex, providing a weighting to disaggregated costs seems like a sensible precaution. Particularly as disaggregated costs are likely to be required for assessing price control deliverables in ED2 as in RIIO-GD2.

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

No response provided

Model Specification

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

No response provided

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

No response provided

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

No response provided

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?

We think that the factors outlined are likely to be some but not all of the company specific cost factors as networks develop a changing and more diverse balance of assets. As outlined in questions COQ1-6, within model planning considerations of the strategic impact of company specific cost factors should be incentivised to encourage long term efficiency through asset choices that are modelled across networks on requirements for levels of consumer outputs, whether load management, connection speed or other service levels that contribute to consumer benefit.

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

Please see COQ14.

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?

In the context of the RIIO-1 controls we estimated that outturn values for Real Price Effects (RPEs) at the RIIO-1 ET and GD controls may be substantially lower than originally assumed by Ofgem, with the regulatory framework which could allow companies to keep up to £0.9 billion of these savings as additional profit.¹

¹ Citizens Advice, [Energy Consumers' Missing Billions: The profits gifted to energy networks](#), 2017.

We support the updated model outlined by Ofgem as an improvement in the interests of consumers.

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?

No response provided.

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

No response provided.

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

We support the principle of an ongoing efficiency assumption for the DNOs. This energy assumption should reflect prior innovation and efficiency which has been evidenced, for instance, through the underspends in ED1, as well as ongoing innovation and efficiency drives in DNOs' operations that will occur during the ED2 price control period. We would expect the efficiency target to be set at a stretching level as it would be if these companies were subject to commercial pressures. We welcome the ongoing discussion with industry and other stakeholders on this topic to develop the efficiency assumption target.

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?

No response provided.

Disaggregated Cost Assessment

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

No response provided.

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

No response provided.

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

No response provided.

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

No response provided.

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

No response provided.

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

No response provided.

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

No response provided.

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

No response provided.

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

No response provided.

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

No response provided.

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

No response provided.

Cost Benefit Analysis

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

We support the use of CBAs for asset categories or classes, or for specific projects where they are sizeable or have different features. CBAs are a complex area and we note the approaches being discussed. We would note, however, that our research into appropriate mechanisms for highly anticipatory investments² does point to how real options analysis may be especially useful at present in the context of a post-COVID-19 environment where there may be more uncertainties regarding demand, affordability, and pace of technological change. As such, our research highlighted how the value of the real option to wait until there is better information may now be higher than in the past. We would recommend that analysis regarding CBAs looks at this aspect relating to the potentially increased value of the option to wait for better information.

Engineering Justification Papers

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

We support the retention of the requirement for DNOs to produce EJPs. In particular, we believe that they will have value when justifying strategic investment or when evidencing information supporting local or regional differences in their licence areas.

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

We support the proposal to retain the assessment framework developed for EJPs as part of the RIIO-2 process. The needs case should provide adequate evidence to support any regional difference that supports the intended investment. See also our comments at COQ32 on CBAs regarding the potentially higher value of the option to wait for better information.

² Citizens Advice, [Meeting net zero - Options for network company highly anticipatory investments in a post-COVID-19 environment](#), August 2020

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

We support the adoption of the principles as outlined within Annex 2. Also see our responses to COQ32, 33, and 34 for specific comments relating to EJPs and CBAs.

Data Assurance and Compliance

COQ36: What specific activities and methods should be adopted to ensure the Data, Data Assurance and Compliance processes of the RII0-ED2 price control are run as effectively as possible?

Please see OVQ16 where we support the emphasis on responding to the modernising energy data recommendations.

Network data accuracy should be a key requirement for Ofgem and therefore stakeholder and consumer trust in price control assumptions. We therefore welcome Ofgem's greater focus on the importance of data assurance. This includes bringing it under one license condition and the proposed review of the Data Assurance Guidance.

We support Ofgem's decision to allow networks to determine the data assurance commensurate with their data above a minimum standard. This allows scope for tailored delivery that has nuance, flexibility and proportionality. Also, we support Ofgem stating it is likely they will specify a minimum data assurance activity for particular submissions. We think good data assurance guidance from Ofgem and network commitments to sharing best practice should both provide example processes for data types. Data assurance will be a key aspect of network digitalisation strategies that deliver better modeling of data through capitalising on opportunities for standardisation, openness and sharing.

Uncertainty Mechanisms

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

We support the use of UMs to address uncertainties outside of the DNOs' control or where the information is not yet available to make sound investment decisions.

We have made comments regarding the Indexation mechanisms either elsewhere within this response to the Annex 2 questions or within the response to the Finance Annex, as appropriate. See also our response to OVQ9 which addresses our comments relating to the various UMs proposed for strategic investment.

With respect to the other proposed UMs listed at Table 7, page 89 of Annex 2, we have the following comments:

- Pass-through mechanisms appear reasonable for the:
 - Ofgem licence fee
 - Business rates
 - Pensions adjustment
 - Miscellaneous matters as outlined within Annex 2 Chapter 11 (such as DCC fixed costs)
- UMs for the following matters appear reasonable to address the current unknown position on scope, timing, party, and costs, and/or where there may be governmental or other policy decisions:
 - Enhanced physical site security
 - Cyber resilience
 - Net Zero
 - CAM
 - Rail electrification
 - Black start
 - Environmental legislation
 - Street works costs
 - Smart Meter interventions

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

We have outlined in the Executive Summary and General Comments sections in our response to the Overview section questions that we believe that there are potential COVID-19 implications that may impact the ED2 price control. These impacts are still emerging but could include changes in demand profile or overall demand, affordability and consumer appetite for new projects. It is probable that these implications will become clearer in due course, which may affect the baseline revenues as well as the UMs. **We would therefore**

recommend that a specific COVID-19 re-opener mechanism is considered to allow for adjustments to baseline or other revenues as better information is gathered on the implications for network operations. See also our response to OVQ34 where we make the same recommendation.

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

We agree with the rationale to remove the Load-Related Expenditure and High Value Re-openers for ED2 given that there is consultation on new proposals for funding strategic investment that may include the use of UMs.

We also agree with the removal of the Link Boxes and Subsea cables re-openers given that the risks associated with these re-openers were removed during ED1.

We agree with the removal of the Innovation Rollout Mechanism as this mechanism no longer fits within the innovation framework funding methodology and mechanisms outlined for ED2 and which is aligned with the RIIO-2 cross-sector methodologies.

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

We support the use of common re-opener design parameters and principles, wherever possible, to simplify processes and to align with the position adopted for the gas and electricity transmission and gas distribution sectors for RIIO-2. We have made comments with respect to the common cross-sector UMs within our response to the RIIO-2 draft determinations consultation³ which may be relevant if Ofgem is seeking further views regarding these specific UMs (e.g. the Net Zero re-opener or the CAM). We have copied below from our draft determinations response⁴ those that are of most relevance:

“Managing uncertainty

Q12. Do you agree with our proposed common approach for re-openers?

We are supportive of re-openers within the RIIO-2 price control, as we believe they will provide flexibility to build on agreed spend where

³ [Citizens Advice response to RIIO-2 Draft Determinations for Transmission, Gas Distribution and Electricity System Operator](#), September 2020

⁴ [Citizens Advice response to RIIO-2 Draft Determinations for Transmission, Gas Distribution and Electricity System Operator](#), September 2020

required. In principle, they offer mechanisms to ensure that investments in assets are facilitated but also that consumers are protected from the risk of stranded assets or from paying unnecessarily high costs. When projects are in an early stage of development and the needs case or cost profile is not clear, the opportunity to delay until there is better information is valuable.

We support the use of a common and broadly defined approach for re-openers with a clear focus on consumer outcomes for network companies. We note that there will be a further consultation on the guidance for re-opener processes and procedures and welcome this consultation to address the issues we have raised in the Executive Summary.

Q13. Do you agree with our proposals on a materiality threshold, a financial incentive, a 'foreseeable' criterion, and who should trigger and make the application?

We welcome the introduction of the Coordinated Adjustment Mechanism (CAM), that can facilitate whole systems solutions through transferring a project from one licence holder to another where there are clear consumer benefits. We note that Ofgem intends to introduce a CAM licence condition, which we support, and welcome the intention for further engagement on CAM guidance with stakeholders. We also welcome the ongoing work being carried out through the Energy Networks Association (ENA) to develop a methodology for whole system cost benefit analysis which will support the CAM.

We understand the rationale for not setting a materiality threshold for such transfers given that the costs for the project are set at the outset of RIIO-2, that consumers will benefit from such a transfer, and that companies will be dis-incentivised from trivial applications due to resource costs. It may be suitable to monitor the extent and value of CAM applications during RIIO-2 to assess whether a materiality threshold would be appropriate if there are many small projects with low consumer benefit from the transfer.

We note that there is not intended to be a financial incentive for the CAM. Network companies repeatedly tell us that they are focussed upon 'Doing

the right thing' and therefore a financial incentive should not be necessary to facilitate a project transfer which is in consumer's interests. Network companies' abilities to agree a compensatory value between transferring companies for any issue relating to a reward or penalty under the Totex Incentive Mechanism (TIM) appears appropriate.

We agree with the proposal to not have a 'foreseeable' criterion for the reasons outlined in the consultation, namely that this may be an additional burden in the application process with little gain for consumers as there should have been sufficient scrutiny at the project's initial application to assess foreseeable issues.

We note that Ofgem intends to introduce a CAM licence condition, which we support, and welcome further engagement on CAM guidance with stakeholders.

We believe that it would be efficient to have the receiving company as the lead applicant with the passing company as the supporting secondary applicant.

Q14. Do you consider that two application windows, or annual application windows, are more appropriate, and should these be in January or May?

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

Q15. Do you consider that the RIIO-1 electricity distribution licences should be amended to include the CAM, or wait until in 2023 at the start of their next price control?

We believe that there is merit in considering amendment of the RIIO-1 electricity distribution licences to include the CAM. Such an amendment will facilitate the operation of the CAM across all licensed network companies as rapidly as possible to enhance consumer benefits.

Cyber resilience

Q16. Do you agree with our proposed re-opener windows for cyber resilience OT and IT, and our proposal to require all licensees to provide an updated Cyber Resilience OT and IT Plan at the beginning of RIIO-2?

Cyber resilience is an essential element for a network company and we support the re-openers noted within this section to facilitate improvements in cyber resilience as needed. We do not see value in the re-opener windows, as with materiality thresholds, where networks require a re-opener they should be unconstrained by rather arbitrary parameters.

Q17. What are your views on including the delivery of outputs such as: CAF outcome improvement; risk reduction; and cyber maturity improvement, along with projects-specific outputs?

We think Ofgem has set out a clear range of delivery outputs.

Non-operational IT and Telecoms capex re-opener

Q18. Do you agree with our proposal for the Non-operational IT and Telecoms capex re-opener?

We support the proposal for the re-opener as described in this section. The re-opener should provide the flexibility for companies to upgrade systems to improve efficiency and operational capability while providing suitable scrutiny.

Physical security

Q19. Do you agree with our approach to using a re-opener mechanism for changes to government physical security policy?

As custodians of Critical National Infrastructure, the network companies may require additional funding in response to any government mandated changes. A re-opener mechanism to provide funding in these circumstances appears reasonable.

Addressing changes to legislation, policy and technical standards

Q20. Do you agree with our approach regarding legislation, policy and standards?

We note that Ofgem are not proposing any additional re-opener mechanisms relating to changes in legislation, policy or technical standards. While some companies put forward requests for bespoke mechanisms to manage risks such as those associated with Brexit, environment and climate change, and black start resilience, Ofgem has viewed that they had insufficient information to justify the need for such mechanisms. The consultation asks for further information regarding the types and magnitude of possible changes that could create increased costs from changes in legislation, policy and standards. We believe that the network companies are best placed to identify and propose forecast costs for these issues. We would support a re-opener for relevant changes if there is sufficient justification and clarity on costs, although we note the range of proposed uncertainty mechanisms within RIIO-2 that may already provide support for changes in this area, such as the mechanisms relating to Black Start, Net Zero, Heat Policy, etc.

Net Zero re-opener

Q23. Do you have any views on our proposed approach to a Net Zero re-opener?

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

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

As stated in our answer to Q22, we believe that the widely-drawn framework of the Net Zero re-opener is an advantage in helping to meet potential currently unknown or less certain requirements to meet Net Zero. In addition, the cross-sectoral nature of the re-opener allows funding to be allocated to which industry sector needs it at that time. We note the discussion regarding the ability of Ofgem to solely initiate the

re-opener and how some network companies wished to be able to trigger the re-opener. We appreciate the mitigations for network concerns that have been proposed such as consideration by Ofgem of matters raised through the Net Zero Advisory Group (which includes membership of the National Infrastructure Commission and the Committee on Climate Change), and the consultation process that will accompany any changes in circumstances when considering potential activation of the re-opener.

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

As we have noted earlier, we recommend that Ofgem produces high, medium and low scenarios for the additional cost allowances that may result from re-openers along with the impact on customer bills and for meeting Net Zero. By way of illustration, our high level calculations presented in Appendix 2 suggest that the Net Zero re-opener alone could lead to customer bill increases of between £6.15 and £33.48 per household per annum by the end of the RIIO-2 period. If the outturn value is towards the upper end of this range, it would more than offset the £20 customer bill reduction that Ofgem has highlighted in its draft determinations.

See also our answers to Q21 with respect to the need for scrutiny of information in light of likely changes due to the COVID-19 pandemic including issues relating to changes to willingness to pay, the need for cost and benefit analysis amendments to incorporate wider scenarios, and the potential reduced ability of consumers to afford the funding of large investment projects. We would ask that the projects funded under the Net Zero re-opener routinely considers any distributional impacts relating to the project to ensure that certain consumers, e.g. those with

vulnerabilities, are not left behind in the transition or negatively impacted.”

Increasing Competition

In the matter of competition in general, we are in agreement with Ofgem’s overall intention to increase the use of competition where it is in the interests of consumers, and the specific intention to introduce new forms of competition in ED2. The introduction of new DSO functions within DNOs offers further opportunity to ensure that competition will provide cost-efficient solutions for consumers.

See also our response to Annex 1, OUTQ3 and OUTQ8 addressing certain aspects relating to competition. We favour effective competition where it is possible to ensure that companies are driven to deliver excellent customer service to customers, which will become increasingly important during ED2. **We therefore recommend that Ofgem reconducts its Competition Test Process to ensure that where there is not effective competition, that the price control drives this behaviour. As the results of the last test were obtained in 2014, it is important that this is carried out again so that Ofgem takes decisions about ED2 on up to date evidence.**

OQ41: Do you agree that our flexibility proposals are sufficient to incentivise DNOs’ native competition?

We note Ofgem’s view that the requirements of considering flexibility as an alternative to infrastructure reinforcement and the DSO incentive framework will encourage native competition, in addition to the existing TIM mechanism. We support the requirements for the DSO functions which should aid in driving cost-efficient solutions. As we have stated elsewhere within this consultation, **we recommend that revenues and costs for DSO functions are separated to aid in the transparency of costs across the industry and to enable the benefits of competition and efficiencies to be identified.** See also our response to Overview, OVQ17.

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?

See our response to COQ43.

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

We note Ofgem's views relating to early competition where early competitions can produce benefits for consumers by revealing new or innovative ways of solving network problems (such as network constraints) and avoiding expensive reinforcement costs, for instance by using flexibility providers. As stated in Annex 2, early competitions can play a role in revealing the best ways of designing, constructing, financing, operating or maintaining assets. The new DSO functions may also provide opportunities for the use of early competition. We note that Ofgem is awaiting the production of the Early Competition Plan (ECP) (due February 2021) by the ESO to conduct an impact assessment as to whether the learnings from the ECP can be applied to the electricity distribution sector. We welcome Ofgem's proposal to see how the ECP can be applied to the DNOs operations including the DSO functions. We addressed our views on the ECP and wider competition with our response⁵ to the draft determinations for the RIIO-2 companies, and have reproduced our comments below. We reiterate our view that it would not be appropriate to draw firm conclusions on the nature of early competition in the electricity distribution sector until the ECP has been produced and the impact assessment has been conducted. However, **we recommend that consideration is given by Ofgem and the ESO within the ECP to look at collaboration between DNOs in designing and implementing systems, infrastructure or processes, and putting these projects out to competition. This may be particularly applicable for new DSO functions, as it may be more cost-effective for consumers to have one or fewer solutions than 6 different systems.**

"Competition is a vital element within the investment assessment process to ensure that consumers get best value for money. We note that the projects proposed for the baseline allowance funding is not being considered for competition as competition models may not be sufficiently developed or the projects may not be readily separable due to the projects being largely related to upgrading of existing assets. There is also an apparent time criticality for these imminent projects. We understand the rationale for the decision to not require competition for these projects particularly given the large number of projects that have been moved from possible baseline funding into the uncertainty mechanisms (over £5 billion of possible project value). We note that the various re-opener

⁵ [Citizens Advice response to RIIO-2 Draft Determinations for Transmission, Gas Distribution and Electricity System Operator](#), September 2020

mechanisms will have late competition processes applied for their projects across all sectors where they meet the criteria for competition, and that consideration will be given for competitive processes for parts of projects, where separable. We welcome the use of competition for this substantial number of projects which should drive cost-efficient delivery.

We note the reference to 2 projects by NGET and SHET (the Dinorweg-Pentir project and the Skye project) that will now be subject to competition assessment as they are proposed to be part of the Large Onshore Transmission Investment re-opener. We believe this to be in consumer's best interests to ensure value for money.

We note the continued development of the competition models and would point to our response to the Sector Specific Methodology consultation (at page 32)⁶, where we highlight where the administrative costs of running a competition may outweigh any savings from being competitive. We trust that the competition models will take this point into account in their design. We also noted in our prior response that we felt that a threshold of £100 million may exclude projects that may be suitable for competition. We note in the draft determinations consultation that whole or parts of projects may be suitable for competition, and we recommend that any threshold for including competition is set so as to include as many projects as possible, subject to the competition being run cost-effectively, and so that delivery can be timely, if urgency is a factor.

Introduction of early competition

Q33. Do you agree with our proposed approach on early competition?

We note the ongoing development of the Early Competition Plan (ECP) by ESO which will likely include projects of value £50 million or over. The ECP has a planned date for conclusion of February 2021 but we note that key aspects of the model are still to be finalised and that early competition proposals are therefore not yet finalised for RIIO-2. We note the consultation position that the early model will not be applied to projects receiving baseline funding, presumably for similar reasons as outlined for late competition (see Q32 above), but may apply to those projects eligible for the uncertainty mechanisms, subject to further consultation. We await

⁶ Citizens Advice, [Response to the Ofgem RIIO-2 Sector Specific consultation](#), March 2019

further information on the ECP and its parameters with interest, and agree that until the ECP is finalised, that it would not be appropriate to make any firm conclusions about its implementation for RIIO-2 as yet.”

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

No response provided.

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.

We are supportive of the use of late competition to reduce the costs for consumers and to introduce innovative solutions. We note the balance required between using late competition processes to save consumer money and the additional costs that may result from running such competition processes. As such, we are supportive of the use of late competition processes where the benefits for consumers will outweigh the costs of the processes.

We note the intention for Ofgem to introduce the same 3 late competition models as seen for RIIO-2 and welcome the consistent use of models to aid in clarity and process considerations. We agree with the principle that there is no reason why these models cannot be used for the electricity distribution sector.

The criteria for selecting projects that may be suitable for late competition processes which were developed for the transmission sector appear suitable for the electricity distribution sector, including that the project is new, separable, and of high value. The threshold for high value that is proposed in ED2 is for those projects above £100 million. We note that project packaging may also be used within ED2 as proposed for the transmission sector, where smaller projects could be bundled, split or re-scoped. **As stated in our response to COQ43, we believe that the £100 million threshold may unnecessarily exclude projects. We would recommend that consideration is given to reducing the £100 million threshold provided that the costs of the competition are lower than the expected benefits for consumers of running the competition.**

As stated above for early competition, **we would further recommend that consideration is given by Ofgem and the ESO within the late competition proposals to look at collaboration between DNOs in designing and**

implementing systems, infrastructure or processes and putting such projects out to competition. This may be particularly applicable for new DSO functions, as it may be more cost-effective for consumers to have one or fewer solutions than 6 different systems.

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

See our response to COQ45.

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

See our response to COQ45.

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)?

See our response to COQ45.

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

We support the proposed range of options for repackaging projects in ED2. Please also see our comments within COQ45 regarding collaboration of projects across DNOs.

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

No response provided.

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?

We support the use of the CDIR methodology for ED2. This methodology is consistent with the approach taken with the gas and electricity transmission and

gas distribution sectors for RIIO-2 and offers an incentive mechanism that reflects the different confidence levels of types of costs.

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

We support the proposed design of the BPI for ED2 which is consistent with the approach taken for gas and electricity transmission and gas distribution sectors for RIIO-2. We note the additional guidance provided for the CVP element of the BPI and this is welcomed. We have further comments regarding the CVP at COQ54.

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)?

We support the proposal that Ofgem establishes a set of baseline standards against which DNO performance can be assessed in ED2, as part of separate ODIs relating to DSO, vulnerability and major connections. We have provided comments elsewhere in this consultation regarding these baseline standards. We support the use of stakeholder proposals into baseline standards, including using those proposals identified at the draft Business Plan submission stage.

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

We support the additional guidance provided for the CVPs in ED2. This guidance and the cap on the number and value of proposals should assist in avoiding the issues identified within the RIIO-2 CVP submissions which resulted in many time-consuming proposals being made of which the majority was ultimately unsuccessful. We note that the CVPs will be restricted to certain areas only:

- DSO activities
- Services for customers with vulnerabilities
- Services for large connection customers
- EAPs
- Whole system approaches

We support the guidance to restrict CVPs to these topics, however, **would recommend that a further category is permitted to allow for companies to suggest CVPs that assist in services relating to the new overarching licence obligation to treat customers fairly.**

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?

We welcome the details provided within the BP Guidance. **We would recommend that the Guidance is updated to encourage hyper-linking and cross-referencing of data within BPs. We would also encourage the use of infographics to assist in the readability and understanding of data provided in BPs.**

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?

No response provided.

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?

We support the use of minimum requirements for Stage 1 of the BPI to encourage the submission of high quality BPs that address the most important areas of these businesses. We support the use of a reward/penalty mechanism as well as the requirement that companies must meet Stage 1 minimum requirements for CVPs to become eligible for reward. We support the materiality assessment of the Stage 1 BPI process including an analysis of the consumer detriment that may be expected as a result of any failure at Stage 1.

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

We support the approach for assessing CVP proposals including the adoption of some proposals from the draft BPs to be used in baseline standards. We note that clawback mechanisms are being considered for CVP proposals for ED2 and **we would recommend that clawback mechanisms are used where there is part- or non-delivery of the CVP.**

We welcome the requirement to outline stakeholder support for CVPs, including the extent that the CVP has been reviewed and received support from the Ofgem RIIO-2 Challenge Group, CEGs, and other stakeholders. **We would recommend that the CVP assessment by Ofgem clearly outlines how much weight has been put upon this stakeholder support to provide transparency in Ofgem's decision-making. This aspect is particularly important where a CVP which appears to have had strong stakeholder support is rejected by Ofgem.**

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?

See our response to COQ55.

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