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Dear Jonathan

Open letter on the RIIO-2 Framework

We are delighted to have the opportunity to respond on behalf of the Electricity System Operator (ESO) to Ofgem's open letter on the RIIO-2 framework. Our response is made up of a number of high level comments on the proposed objective and principles, followed by more detailed answers to the specific questions set out in the open letter, where applicable to the ESO. While our response is from the ESO only, we note that system operation should be considered holistically and many of the concepts apply to operation of both the gas and electricity systems.

We are in the midst of a period of unprecedented change in the energy system. The economic landscape, technology and consumer behaviour are changing at an unparalleled and unpredictable rate: for example, in 2011 we forecast that in 2020 there would be 1GW of solar PV capacity and 12% of installed capacity would be embedded in the distribution network; those figures are currently at 12GW and 27% respectively¹. We will continue to see increasing levels of distributed and renewable generation, new technologies and fresh business models, and work is needed to decarbonise the energy system and ensure security of supply in the most affordable manner. Our customers and stakeholders consistently tell us that affordability, security and sustainability are all essential and we must focus on these as we explore new ways to enable smart and flexible solutions.

The role of the ESO is fundamentally linked to the underlying energy market structure and, as this has changed, the role of the ESO has grown and evolved. We welcome Ofgem's recent decision to create a National Grid Electricity System Operator (NGESO) company within the National Grid Group from April 2019, legally separate from the Electricity Transmission Owner. The ESO will be a different type of company: a unique enabling business that provides specialist services; manages significant risk; delivers, and allows others to deliver, real value for consumers across the energy system. We need to develop a regulatory framework for RIIO-2 that maximises the opportunity for the ESO to facilitate the decarbonisation of the energy system and ensure security of supply in the most affordable manner.

RIIO-1 has delivered efficiencies across the network companies, sharpened focus on stakeholder-led outcomes and stimulated new focus on innovation. We believe in the RIIO principles and that consumers will be best served by considering how to apply them to the ESO at the heart of the energy system. We do not yet have a precise view of what the RIIO price control for the ESO should look like, but it must involve defining new ESO-specific outputs and must reward us for the value that we deliver across the energy system. In developing our views we will learn from RIIO-T1, the new 2018-2021 regulatory and incentive framework and other SOs across the world. We are looking forward to discussing fresh approaches with customers and stakeholders to determine the best RIIO-2 arrangements for the ESO, in such a way that resolves the important issues of

¹ <http://fes.nationalgrid.com/fes-document/> (2011 and 2017 FES documents)

security of supply, affordability and decarbonisation while delivering value for customers and consumers.

Our recently published Future Energy Scenarios (FES) document shows the need for action now to remove barriers to competitive markets for a wider range of technologies and business models to optimise the value of the energy system. We will engage with stakeholders to understand their needs and concerns, and partner with our customers as we bring them to the heart of our business. The energy market needs to be transformed to be able to meet the needs of future energy users, and we want to continue to lead this work. We need to define specific outputs for the ESO that reflect the pace of change desired by customers and stakeholders, the need for stability in the regime for all investors, and what can pragmatically be achieved within our allowances.

The over-arching objective that *“RIIO-2 will ensure regulated network companies deliver the value for money services that consumers want and need”* is focused on affordability. We support this focus, but believe the objective does not adequately capture the need for continued emphasis on decarbonising the energy system and embracing the smart potential that serves consumers, today and in the future. There is a clear ambition for decarbonisation in discussions across the industry, and throughout the suite of helpful documents recently published by Ofgem²; it would be useful to have the objective explicitly highlight the need for sustainability and security of supply to ensure there is clarity for the price controls.

Giving consumers a stronger voice in setting outputs, shaping and assessing business plans

Engagement with consumers is vital to ensure that the future energy system delivers for them. We need to explore different channels to bring consumers and all other stakeholders into the conversation and make sure that they receive the information they need in order to actively participate in the RIIO process. Our customers are a critical link to consumers; we will partner with them to ensure we deliver for consumers. We must also ensure that consumers can see how their input has shaped the final business plan.

Allowing regulated companies to earn returns that are fair represents good value for consumers, properly reflecting the risks faced in these businesses and prevailing financial market conditions

We fully support the principle that all parties must be allowed to earn a fair return, and companies should provide sufficient information so that all stakeholders can understand how this has been achieved. We need to clearly define the value the ESO delivers and explore the best way to calculate a fair return. Clear outputs, risk allocation and management of uncertainty are key to assessing what is a fair return for the ESO and for holding us to account.

Incentivising companies to drive consumer value by shaping or proactively responding to changes in how networks are used and services are delivered

We agree with Ofgem’s thinking, as set out in *‘Our Strategy for Regulating the Future Energy System’*³, that building flexibility and resilience into regulation is essential to enable agile responses to upcoming changes. RIIO-2 must support us to be pro-active: specific outputs for the ESO should be developed to enable this, and application of this principle should give us the space to learn by doing, rather than committing to solutions before impacts are understood. Alignment of expectations and incentives across the industry is important to encourage whole system thinking and ensure everyone is incentivised to play their part. Developing transparent mechanisms to manage uncertainty and change throughout the price control period is essential.

Using the regulatory framework, or competition where appropriate, to drive innovation and efficiency

We agree that the price controls should continue to focus on efficiency. Nevertheless, investment in the ESO is critical to helping others create and unlock value in the energy system, so the right balance between efficiency and investment needs to be struck. Innovation is vital, now more than ever, given the pace of change in technology and the opportunities this offers for consumers. The Network Innovation Competition (NIC) and Network Innovation Allowance (NIA) have been important catalysts for building partnerships, and there must be ongoing incentives to ensure that this way of working across the industry continues. Where appropriate, we want to consider the

² https://www.ofgem.gov.uk/system/files/docs/2017/08/our_strategy_for_regulating_the_future_energy_system.pdf; <https://www.ofgem.gov.uk/publications-and-updates/targeted-charging-review-significant-code-review-launch>

³ https://www.ofgem.gov.uk/system/files/docs/2017/08/our_strategy_for_regulating_the_future_energy_system.pdf

development of outputs or incentives to enable us to explore further potential for competition in the markets that can deliver the best outcomes for consumers.

Simplifying the price controls by focusing on items of greatest value to consumers

We agree with Ofgem that it is important to focus on issues of greatest value to consumers; we should ensure we consider what these will be in the future as well as maintain a focus on priority issues now, such as security of supply, to ensure that existing valued outcomes remain understood and fit for purpose. In light of the increasing complexity of the operation of the electricity system, providing accessible information and working in partnership with others is key to ensuring we correctly identify and focus on items of greatest value to consumers.

We agree with the principles in the open letter in general, but would like more clarity on how the thinking Ofgem has set out across its recent suite of strategy documents comes together to inform the principles and objectives for the development of RIIO-2. We look forward to continuing to work with the industry, consumers and Ofgem to shape RIIO to ensure that we can collectively deliver a secure, sustainable and affordable energy system that delivers value for all future users.

Yours sincerely,

[By e-mail]

Phil Sheppard

1. Do you agree with our overarching objective for RIIO-2 and how we propose to achieve it?

The focus of the objective on affordability is welcome and essential. We believe that it should be broadened to explicitly include security of supply and sustainability in order to ensure that the principles can work in practice and that the energy system can deliver what consumers want and need. Looking out across the 2020s and the level of change needed, consumers will benefit from explicit focus on these areas.

We support the broader focus of Ofgem's future regulatory strategy document and would like to see how the principles and objectives set out in both will be brought together to apply to RIIO-2.

2. How can we strengthen the consumer voice (primarily end-consumers) in the development of business plans and price control decisions?

The energy system exists to serve consumers and they bear the ultimate cost, so it is right and vital that they have a voice in RIIO. Our current view is that we need to present them with useful and accessible information through appropriate channels of engagement for different groups; this will enable them to actively participate, without creating an excessive burden. We can learn from others' best practice as well as build on our own successful experiences; for example, we are exploring collaborative ways of working in our electricity charging review, such as publishing joint publications with consumer groups to describe how network charging works. We also know that our customers and service providers are key to continuing to understand what consumers value and working in partnership with them is crucial; by continuing to improve our delivery for customers, we can enable them to deliver the services consumers want in an efficient manner. Through our stakeholder engagement on Future Role of the SO and other forums, we are continuing to develop our customer and stakeholder strategy, which will maintain our efforts to serve consumer needs by partnering with our customers and stakeholders. Focusing on these activities will enable us to effectively engage with consumers and clearly reflect what is important to them in our business plan.

3. How should we support network companies in maintaining engagement with consumers throughout the price control period?

It would be helpful for Ofgem to provide clarity on what they need to see to be confident that we have translated stakeholder insights into our business plans. Ofgem could also usefully consider and suggest shared panels and events that can be used for common themes between us, the network companies and Ofgem. We believe this will improve transparency of the overall process and avoid overburdening consumers and other stakeholders. We recognise that different customers and service providers may want different outcomes, so we need to be able to identify areas of common ground where appropriate and to reflect where trade-offs have been made.

4. Does this structured approach to defining outputs provide the right level of clarity around delivery?

RIIO-T1 did not explicitly set outputs for the ESO. Looking forward we must ensure that we develop outputs specifically for the ESO that reflect our role. Our current view is that the structured approach to defining outputs, of output categories with further detail on what is required in each area, is useful. We must ensure that output categories as well as primary and secondary outputs reflect what consumers need from the ESO. This would provide certainty on how we are going to address their needs and deliver value. Making sure it is sufficiently flexible will enable us to adapt and respond to the fast changing energy system to develop the network that customers and consumers need.

5. How can the outputs framework be improved, including the introduction of additional output categories, for example around efficient system operation for distribution network companies?

The outputs framework should be improved to include ESO-specific outputs, allowing for them to change during the course of the price control given the rapidly changing environment. These outputs should take into account the impacts of changes across the system on the role of the ESO. The framework should also recognise the need for and potential benefits of whole system thinking across gas and electricity and transmission and distribution, and should allow for such coordination. For example, both gas and electricity technologies and infrastructure are going to be needed in the future to provide decarbonised light, heating, transport and industrial processes, so optimising across the two systems may bring benefits for consumers. We believe that evolving the outputs framework in this way is the best way to serve consumers, and we will work with our customers and stakeholders to develop the outputs they want and need from us.

6. Did the outputs target the right behaviours?

RIIO-T1 did not include specific ESO outputs, so we have considered what has been delivered by the SO as part of NGET and through the Balancing Services Incentive Scheme (BSIS). Through this combination of the current RIIO outputs and BSIS we have delivered significant customer and consumer value: for example, through Power Responsive we are removing barriers to market for new flexible technologies such as storage and Demand Side Response (DSR)⁴. This value was not driven by RIIO-T1 outputs in isolation. For RIIO-2, we need to develop new ESO-specific outputs to ensure the ESO is able to deliver its critical role in enabling the transition to the future energy system as this will deliver greatest value to consumers. We are keen to explore this further with stakeholders.

7. How can we address areas of expenditure for which a clear output is difficult to define?

There is an important balance to be struck between setting high level outcomes that allow the ESO to innovate in a changing landscape, while setting clear and sharp outputs that give certainty for customers and consumers around what we will deliver. The current outputs-based and incentives approach has delivered savings for consumers through the ESO innovating and outperforming within our allowances. Going forward, in certain circumstances it may be beneficial for broader outcomes rather than specific outputs to be set; we need to make sure we capture and agree expectations for those areas where anticipatory investment may be needed but forecasting exact requirements in advance will be difficult. One example would be the decarbonisation of heat, and there will be others identified as well. Input from stakeholders will be a key part of this process and we are well positioned to lead the thinking in these areas.

8. Were the outputs and associated financial incentives for RIIO-T1 appropriate, reflecting what consumers value and are willing to pay for?

RIIO-T1 in isolation has not enabled or rewarded the ESO for all we have needed to deliver for our customers in the shifting energy landscape. The scale of change we have managed over the price control so far is significant, yet the value of the SO incentive schemes does not reflect this. Despite this, the ESO has responded to what customers and stakeholders wanted and over-delivered compared to expectations of the energy system and the ESO at the start of the price control through the combination of NGET outputs and BSIS. We have successfully integrated around 20GW of renewable generation into the energy system between 2013 and 2016⁵ and kept balancing costs stable during this period. Going forward, our outputs and incentives structure needs to fully recognise and reward our delivery to enable us to invest and proactively respond to change.

9. What changes in the RIIO framework would facilitate returns that are demonstrably good value for consumers?

⁴ <http://powerresponsive.com/>

⁵ <https://www.gov.uk/government/collections/digest-of-uk-energy-statistics-dukes> (Capacity of, and electricity generated from, renewable sources (DUKES 6.4))

It is important that the RIIO framework provides the opportunity for the ESO and network companies to earn a fair return on clear outputs that customers and stakeholders want, in such a way that benefits consumers. A fair return for the ESO is likely to be different to that of a traditional network company; we need to be properly rewarded for the risks we hold on behalf of consumers. This involves developing new outputs that are specific to the ESO and making sure we are transparent about the actions we take. The framework also needs to build in transparency on the assumptions and expectations made when the outputs are set, so it is clear when and why returns need to go up or down. We will take the initiative and engage widely to consider and agree appropriate returns, metrics and benchmarking.

10. How can we minimise the scope for forecasting errors?

The RIIO-2 price control needs to manage uncertainty and significant change in the energy industry, and we must work together to develop the best ways to do that. Differences between reality and forecasts are often inevitable; sometimes they are not errors but simply manifestations of the real world. This is especially true with the pace and scale of change in the energy industry being unprecedented. Careful thought needs to be put into making sure that risks lie with the parties that can best manage them. Focusing on this principle will drive more value for consumers than focusing on forecasting differences that are the natural consequence of managing those risks.

11. What constitutes a fair return for a regulated monopoly network, and how can we ensure that returns remain legitimate in the eyes of stakeholders?

The returns for the ESO should be grounded in the value that it delivers and should recognise the different nature of the ESO from the traditional network companies. We welcome Ofgem's recognition that, during 2013-15, incentives drove the ESO to reduce balancing costs by around £200m, equating to £150m of benefits to consumers. We consider that the current metrics may not be the most appropriate to measure returns for the ESO, and that alternatives should be explored. The ESO will have greater exposure to systematic risks (for example technology change risk and a higher ratio of direct costs to RAV) and will need to be compensated for this through their base equity return. In addition, the investment National Grid has made in people development needs to be recognised and suitably compensated; there has been investment to create the critical mass of operational skills, competences and experiences that will continue to bring benefits to present and future consumers.

12. What factors do you think are relevant for assessing and setting the cost of capital so it properly reflects the risks faced by companies?

Any metrics used to set the cost of capital must reflect the risks faced by the ESO as an asset-light, people-driven organisation. Equally, the principles of stable regulation need to remain throughout the approach taken to setting the cost of capital. Even though the ESO has some shorter term operational cycles it remains a long term business managing long term risks, and the approach to setting cost of capital needs to reflect this.

13. Can we improve our methods for the indexation of the costs of debt and equity?

14. Are there specific amendments to any core aspects of financeability that we should be considering in light of performance during RIIO-T1 and the change in the financial environment?

15. Should we consider moving to CPIH (or another inflation index) and how should we put into effect any change to ensure it is present value neutral for investors?

We defer to the response of NGET for questions 13-15.

16. Do you think there are sufficient benefits in aligning the electricity price controls to offset the disadvantages we have outlined?

17. Are there any other realignment options we should consider?

We agree that there are advantages and disadvantages with aligning the price controls. Technology is currently advancing faster than policy and regulation and agile delivery across the energy system is needed. We think that a number of approaches to provide incentives for agile action across the energy system should be considered. One approach is to strictly align the timing of the price controls, but there are also others to explore. We need to ensure that focusing on perfect alignment doesn't limit thinking to just the traditional network companies, and that we are enabling broader alignment across the energy system. We should focus on aligning expectations so that we are able to deliver for customers in every changing landscape rather than setting an expectation that strict alignment is necessary for effective progress.

18. What amendments to the RIIO framework, if any, should we consider in supporting companies to make full use of smart alternatives to traditional network investment?

We strongly agree that flexibility in the RIIO framework is needed to allow for technologies and business models that have not yet been developed. New outputs for the ESO are needed, such as around market facilitation. This is a key role we already undertake that contributes directly to our Customer Satisfaction output under RIIO-T1, but our market facilitation role will become increasingly important and may change substantially in the future given the evolution of the energy industry. We should therefore consider whether new outputs around this may need to be defined.

We need a strong focus on transparency to ensure that decisions around investment are clear and understood and that parties can bring forward new technologies. We must also look wider than the RIIO framework to make sure that all arrangements – market, policy, regulatory, ownership – do not impose unhelpful barriers; RIIO is one part of enabling a smart future. We need to ensure that incentives remain for the network companies to invest in smarter alternatives as well as the ESO. If there are additional barriers to entry for other providers for smart solutions, we want to work with Government, Ofgem, and other stakeholders to make sure that those barriers are broken down and consumers can benefit from that investment.

19. Given the uncertainty around demand for network services, how much of an issue might asset stranding be and how should this risk be dealt with?

We agree with Ofgem that investment in uncertain times brings risk; but it must be recognised that failing to invest early enough could be as damaging to consumers as the risk of stranded assets. For example, a network to transport power from new distribution sources to consumers across the whole system is needed for the market to function and for consumers to enjoy the standard of supply they expect. The challenge for RIIO is how to enable investment decisions to be taken in this unpredictable environment and how to anticipate the investment needed to deliver secure, sustainable energy to end consumers. The Networks Options Assessment (NOA) process, which has only been in operation for two years, aims to provide information to parties to understand what the system needs are and the impacts of investment decisions. We will continue to evolve this process in collaboration with stakeholders.

20. How do we need to adapt the RIIO framework, and the uncertainty mechanisms in particular, to deal with this uncertainty?

21. Is an eight-year price control period with built-in uncertainty mechanisms still appropriate given the greater range of plausible future scenarios?

Effectively dealing with uncertainty is a priority for RIIO-2. The level of change we are seeing in the industry is exceptional, and the impact on the ESO is significant. We want to ensure the ESO is enabled to proactively deliver for our customers and consumers rather than constrained during the price control.

As Ofgem note, there are different ways to manage uncertainty that should be explored in the context of a legally separate ESO: uncertainty mechanisms and the duration of price control are two options. Alternatives should also be considered; the experience of other SOs and regulated businesses may be helpful in developing thinking about a new approach.

We see risks and benefits associated with shorter and longer price controls. Given the expected energy landscape, our current view is that eight years may be too long for an ESO price control.

However, we believe that multi-year schemes are needed to enable transformation and the creation of real value for consumers. As the duration of the price control for the ESO is explored it could be helpful to consider significant events that may spark a change in behaviour or outputs from the ESO, such as decarbonisation of heat or a change in how we discharge one of our roles. The crucial consideration in any thinking must be how to deliver enduring benefits to consumers.

22. What improvements should be made to the assessment of business plans?

23. Should we give further consideration to companies' historic performance against their business plans?

This is the first time we are developing a separate price control for the ESO. We must explore what a useful indicator will be for the ESO, as currently we only have an NGET baseline that would encapsulate all elements of the regulatory framework. We must also consider how and whether a RAV-return only arrangement would work for the ESO; it is essential that we construct a structure that funds the ESO to deliver what is needed for customers and consumers.

Based on the level of change we are seeing in the energy system and our feedback from customers and stakeholders, we expect the demands of the ESO to vary in the future; therefore past performance may not be the best indicator of future performance. Nevertheless, it is right to consider how companies have performed in order to learn from past experience and ensure the best settlement is delivered for consumers. We should be forward-looking in shaping RIIO to best fit the challenges and opportunities we face in the future.

24. Should we determine the revenues an "efficient" network company requires before seeking information from the companies themselves?

We welcome a focus on transparency. We need to recognise the asymmetry of information available and the need for stakeholders to understand costs, drivers and consequences so that they can make informed choices. We also agree with the principle Ofgem has set out in its future regulatory strategy paper to ensure that charging for monopoly services reflects incremental costs and benefits and recovers other revenue requirements in ways that are fair and reduce distortions. We do not think that Ofgem should set revenues for the ESO before seeking information from the ESO, given the potential for inefficiency in the process; we will be open with Ofgem about our new balance of revenues and risks, and want to work together to set appropriate levels that will ensure good outcomes for our customers and consumers and that reflect the value that the ESO delivers. Focusing on these aspects could allow Ofgem to realise benefits without the disadvantages of having to collate and potentially duplicate work undertaken by the companies.

25. What has an eight year price control period allowed network companies to accomplish or plan for that would not have occurred under a shorter price control period?

We agree with Ofgem that an eight year price control for RIIO-1 has provided greater revenue certainty for network companies and their investors, which has allowed them to take long term decisions in the interests of consumers. Over RIIO-T1 we have kept balancing costs stable against a dramatically changing landscape; listened to customers to start an overhaul of our balancing services; driven support for DSR through Power Responsive; and become the trusted source of energy information through our Future of Energy suite of documents.

In determining the length of the price control, a balance between certainty and flexibility must be struck. It must be recognised that issues around security of supply, affordability and sustainability require long term structure, but the price control also needs to be agile to enable us to constantly adapt to the fast changing landscape. An eight year price control may not be right for the ESO.

26. How well has the IQI and efficiency incentive worked in revealing efficient costs through the business plan process and encouraging efficiency throughout the price control?

It is important that an ESO that delivers on an ambitious plan against the backdrop of a fast changing energy landscape is fairly rewarded. We understand that providing good quality and timely information and accurate cost forecasts will be an essential part of this.

27. What alternative approaches could we consider to encourage companies to give us high quality information that minimises the damage from their information advantage?

We understand the need to provide Ofgem and industry with necessary information in a timely manner and helpful format. Through continued stakeholder engagement, we will work with the industry to determine what more we can do in this area as we strive to be more transparent. This could include benchmarking the quality and timeliness of our information against comparable organisations. Furthermore, we intend to treat the 2018-2021 regulatory framework as a trial period where new ways of sharing information are tested and evaluated through constant stakeholder input and feedback.

28. What impact has the innovation stimulus had on driving innovation and changing the innovation culture?

29. Have the incentives inherent in the RIIO model encouraged network companies to be more innovative and what should we consider further?

The innovation funding for RIIO-1 has driven a step change in the level of innovation delivered across the industry. It has stimulated cross-industry collaboration and allowed parties to learn together about how to explore innovative solutions and identify and mitigate barriers to deployment. This has been the key to the integration of the significant volumes of renewable generation and other new technologies onto the energy system.

The critical nature of the ESO's role makes us naturally risk averse, which is at odds with the inherent risk required when adapting to change. Innovation funding allows us to silo the short term risks of change by conducting trials and tests, giving us the chance to evaluate which projects will deliver value for customers and consumers. Innovation investment and risk undertaken by the ESO lead to benefits for parties across the entire energy system. Innovation funding should continue to be available in RIIO-2 to further enable and develop cross-industry partnerships and for the ESO to realise benefits for the whole energy system.

30. Do you agree that the scope of competition should be expanded in RIIO-2? What further role can competition play?

We welcome being regulated in a way that drives us to deliver the outputs that customers want in the most efficient manner possible. As supported by Ofgem in its fifth principle on competition in their future regulatory strategy paper, competitive markets provide the best overall value for consumers and other users of the system. We will continue to work on competition within the provision of balancing services, and will explore with customers what role they want us to play in this to ensure that the rules and processes are simple, fair and transparent and are well understood by as wide a range of potential providers as possible. We will be discussing ideas for how to do this in our RIIO-2 engagement.

31. Which elements add the most complexity and how do you think that these and the broader RIIO framework could be simplified?

In previous price controls the ESO has been thought of in relatively simplistic terms, without complete clarity on how incentives work between internal and external costs. We need to ensure that RIIO-2 becomes more sophisticated in its treatment of the ESO to reflect its unique nature. We recognise that there are parts of the ESO that customers find difficult to understand; we will continue to engage with customers to identify these and look to reduce complexity in these areas.

32. What improvements could be made to the format and presentation of the business plans?

33. Should the plans be revised at any stage during the price control, for example annually?

Business plans should be transparent, accessible and simple for industry and consumers to read. A revision of business plans during the price control period may be welcomed by customers and

stakeholders. We are conscious that we are delivering for a number of different audiences and want to provide helpful information rather than overburden stakeholders. More consistency in terms of formatting and presentation of the business plans may be beneficial, but should recognise the need for differences between each company and allow each to be innovative in responding and reacting to feedback received from customers and stakeholders. We will explore this further with our customers and stakeholders.

34. Should we retain fast tracking and, if so, for which sectors?

Our current thinking is that fast-tracking could be a useful way for the price control process to be made proportionate and more efficient where appropriate, and potentially applied where stakeholder engagement is demonstrated to be of highest quality.

35. Do we collect the right information in the right format and are there better ways to monitor the performance of companies?

It is in everyone's interests to tackle information asymmetry. We need to better understand what will help consumers, understand the costs and what influences their views; this is essential for companies to demonstrate when earning any returns. We will look to our experience over the 2018-2021 period of developing Key Performance Indicators (KPIs) to see what is useful for customers and Ofgem, and to see if the KPIs bring greater transparency and understanding. We feel this experience should be considered when looking to RIIO-2; the key is to ensure the right information (given cost of collection, relevance to stakeholders and proportionality) is being collected from companies, not necessarily more information.

36. What are your views on how the changing role of the electricity SO should be factored into the RIIO framework, including whether or not the electricity SO should have a separate price control?

RIIO-2 needs to treat the ESO differently as it becomes legally separate. The RIIO approach of focusing on outputs valued by customers, identified through good engagement with a wide community of stakeholders, should be applied correctly to ensure the ESO is rewarded for the value it delivers. This includes looking at the right mix of funding for core activities with strong incentives on efficient delivery, and performance-based incentives to ensure thinking recognises activities where the ESO has significant influence rather than direct control.

Our customers and consumers must be at the heart of the ESO's price control: the context of a rapidly changing energy system is likely to lead to changes in what the ESO is expected and asked to do by customers. We want to develop outputs specifically for the ESO that provide clarity and certainty, while giving us sufficient flexibility so that we can adapt as we learn. We want to develop a framework that: encourages the ESO to look to the future; considers whole system optimisation; can allow for and manage uncertainty; and rewards the ESO for taking action to support the transition to a smart and sustainable energy future that delivers for consumers. We have a key role to support customers and stakeholders given our central position in the industry and our expertise, and to work with others to develop fully functioning competitive markets that drive efficient outcomes for consumers. We need to be funded to do this in a way that exceeds the expectations of our customers and service providers.

37. Do you agree with our broad stakeholder engagement approach set out above?

We broadly agree with the stakeholder approach and fully support the intention to include a wider group of stakeholders; although we would highlight that engagement on issues concerning the ESO may be different to that for the networks. We look forward to contributing to these conversations and engaging with our customers and stakeholders via a number of channels.