

Electricity North West- Written evidence (ONZ0006)

We welcome the opportunity to respond to the call for evidence into Ofgem and Net Zero. Electricity North West is the Distribution Network Operator covering the north west of England serving 5 million customers in 2.4 million premises, across a diverse range of locations including both urban and rural areas from Greater Manchester to Cumbria, including Lancashire and Cheshire. We operate in a sector which is regulated by Ofgem and the challenges and themes set out in the call for evidence will have a direct impact on us, as well as we are able to provide direct feedback and input from a position of our operations being regulated by Ofgem and its regulatory framework for distribution network operators. We work closely across the whole energy system with all parts who are regulated by Ofgem, so have a wide experience.

Achieving Net Zero will require whole system thinking and action by stakeholders, in which we are already engaged. With the likely increased dependence on the electricity network of the future, the joint challenges of decarbonisation and assisting customers in vulnerable situations are central to our strategy over the coming decades. Innovation like CLASS¹ means regulation needs to ever more adapt as new solutions to enable the achievement of net zero come forward.

Given this, and in having reviewed the call for evidence questions, we offer the comments/observations given our experience from operating in an Ofgem led regulatory framework and having a key role in delivering activities to achieve and support a successful transition to Net Zero in the submission below this letter;

- The role of Ofgem is vital, though is *not* the single leading role, but one that is crucial in the context of Net Zero transition, to enable, facilitate and support the delivery of Government policy. We welcome the leadership shown by Government, particularly No 10 with the clear 10 point plan, BEIS, DfT, MHCLG and HMT as well as other departments.
- We observe good co-ordination between BEIS and Ofgem, our suggestion is that more of this best practice co-ordinating can be deployed between, and to, other Government departments and between them and Ofgem.
- Financeability for individual companies and the ability to attract efficient investment (both equity and debt) is crucial to Net Zero transition and Ofgem has a central role and duty to ensure this continues for RIIO-ED2 to enable and attract the investment to deliver consumers needs.
- Additional guidance or input from Government policy is required covering the issue of intergenerational fairness and this balance in terms of who contributes for the delivery of Net Zero transition and how net zero is funded. For example will net zero be funded through energy bills or to an extent via other routes.
- A review of the statutory duties of Ofgem to be undertaken at this stage in the context of Net Zero transition and rapid industry change is needed and will benefit the achievement of net zero and can inform what weight Ofgem places on associated considerations (e.g. cost, delivery risk, scope of activities that are regulated by Ofgem and the role of competition and no traditional solutions). The lack of explicit and detailed statutory duties has not to date unduly inhibited Ofgem's engagement on net zero – indeed they have been very

¹ <https://www.enwl.co.uk/go-net-zero/innovation/key-projects/class/what-is-class/>

proactive publishing a decarbonisation strategy. This is done under the auspices of their duty to future customers.

Electricity North West Limited response to Industry and Regulators Committee call for evidence into Ofgem and Net Zero

What role should Ofgem play in the transition to net zero? What changes, if any, should be made to its remit, responsibilities and resources?

1. As a recipient of policy and strategic direction from Government, Ofgem needs to clearly have obligation(s) on Net Zero which should also consider the hierarchy of this in the context of its current role as an economic regulator. We would like to see holistic decision making which is transparent and where trade-offs between conflicts are being evidenced and set out in the public domain. This will allow all stakeholders to see the basis and evidence as to why a decision and trade-off has been made by an Ofgem decision/determinations. Currently there is a risk regulatory discretion is interpreted too widely, whereas discretion needs to be exercised carefully to ensure that decisions made in the round and transparently.
2. Therefore, we support a review of the statutory duties of Ofgem be undertaken at this stage in the context of Net Zero transition and rapid industry change which we would welcome the opportunity to input to it. Additionally, it is important that Ofgem's statutory duties need to be clearly signposted, robustly articulated, properly interpreted and accessible to all.
3. The framing of the Ofgem role in Net Zero transition is vital to help ensure that all actors and stakeholders are playing their parts in a coherent and joined up delivery chain. Our view is that the role of Ofgem is critical but is not *the* leading role, but one that is crucial in the context of Net Zero transition, to enable, facilitate and support the delivery of Government policy. It is important Government continues to lead and direct Net Zero which we currently observe taking place and in an effective manner. We note this in the context of the recent policy announcements and consultations which have been released. BEIS is currently leading the majority of the policy on Net Zero, though strengthening government leadership on Net Zero may be advantageous. However, whichever government department leads Net Zero, it needs to provide additional clear guidance to Ofgem to support the development of its regulatory framework that supports the sectors it regulates as well as the companies which operate within it and meets consumer's needs as well as what is done in competitive markets and what level of regulation, if any to overlay with competition (e.g Ofgem's retail market regulation approach).
4. It is crucial that given the role of Ofgem being vital to the success of the Net Zero transition the regulatory framework it sets needs to be agile and flexible to fast paced changes in our sector as the pathway(s) to Net Zero become clearer. Further flexibility and agility in the framework will allow companies to reflect and react to differences in regional stakeholder/ consumer appetite for delivery where these are faster than national policy as defined by local/regional devolved authorities for example.
5. In doing this Ofgem should seek not to be a barrier to delivery, which could occur for example where it fails to set a framework which ensures that companies are able to finance its activities efficiently or companies are not able to respond rapidly to consumers' needs. Net Zero will see the need to continue to attract efficient investment in sector to deliver Net Zero in a timely manner, and so due regard to

the duty of financeability is key to this and Ofgem should ensure the financeability of the individual companies within the sector. This is clearly in consumers interests, but many aspects of Ofgem decision making have been referred to the CMA indicating there are some concerns especially on technical matters, but these are often important to achieving net zero.

6. With regard to resourcing, it is difficult for us to comment on whether Ofgem is adequately resourced or not, but we would state that it is important that resources are sufficient and aligned with the principles, duties and aims and reflects the important role it has in Net Zero transition. We would also note that arguably as important as adequate resourcing is the retention of talent and continuity of personnel and knowledge.

How well does Ofgem balance environmental objectives against its responsibilities in relation to affordability for consumers?

7. It is important that it is not overlooked that Ofgem has a range of environmental objectives such as; statutory obligations, those adopted from EU law and other requirements, and whilst clearly Net Zero transition and delivery is crucial it is not the only environmental objective Ofgem has as our sector regulator.
8. In our experience of operating in the distribution sector the focus and attention of Ofgem in respect of the environment is currently focused on our compliance, as well as appropriate and transparent reporting from companies. A wider role and focus beyond environmental compliance in RIIO-ED2² is anticipated by us, including considering companies wider social responsibility as well as how this relates to customer ability to pay and affordability.
9. The period of RIIO-ED2 is a real opportunity to value all environmental impacts and outcomes and it is our view that a fair balance for all can be delivered in RIIO-ED2. We acknowledge that Ofgem is considering and setting a framework which does have cognisance to wider environmental consideration moving beyond a simple and narrow focus on compliance. We support Ofgem in this direction change. An example of this would be the aim to ensure customers in vulnerable circumstances are not left behind because of the transition to Net Zero. In delivering this through its decisions and determinations as part of the RIIO-ED2 process we would urge the need for Ofgem to be completely transparent in the trade-offs, on what evidential basis and why the decision has been made.
10. We have recently undertaken extensive research and customer and stakeholder engagement as part of our RIIO-ED2 business plan development. The evidence shows that more in this environmental realm is a priority for the representative sample we engaged with.
11. In response our draft RIIO-ED2 business plan for ENWL has several additional environment outputs and outcomes. Examples of this are: undergrounding of overhead lines in areas of outstanding natural beauty (AONB); plus, a commitment to plant 10,000 trees to offset the impact of our activities on the environment as well as the impact of environmental issues such as 'ash dieback'; and plans to enhance and deliver increased biodiversity at a significant number of our operational sites. All these examples have the aim of protecting and enhancing the natural world in its wider form in our operating region delivering on our customer and stakeholder engagement and reflecting Ofgem direction change for RIIO-ED2.

² RIIO-ED2 will cover the period of April 2023 to March 2028

How well does Ofgem fulfil its obligations to consumers? Does Ofgem take consumer views into account sufficiently, particularly those of vulnerable consumers?

12. Greater clarity for Ofgem on the extent of its scope to support vulnerable consumers would be beneficial. This would then be more transparent to all stakeholders as well as helping to shape and co-ordinate policy. Ofgem currently faces a tension as an economic regulator between wanting to see cost reflectivity and provide price signals as well as enabling some support to certain customers. Addressing the issue of consumers needs with particular focus on those of consumers in vulnerable circumstances and affordability links to how far specific energy policy should go relative to government welfare/social security and taxation policy. This also links to many other aspects of government policy that can have a marked impact on consumers in vulnerable circumstances.

13. We as the DNO operating in the North West of England have a high proportion of customers in vulnerable circumstances in our region compared to many other regions of the UK. Additionally, we have some of the most deprived areas in the country in our distribution area. We are therefore acutely aware and proactive in our work that we undertake to support these customers. Our stakeholders have told us that they want us to do even more to help alleviate fuel poverty and to make sure that customers who are already economically and socially disadvantaged are not left even further behind as we respond to Net Zero transition. We have acted on this evidence and insight by including several consumer and stakeholder engagement led commitments in our draft business plan to enhance this support in the period of RIIO-ED2 covering 2023 to 2028. Our draft plans are currently being reviewed by Ofgem, the sectors challenge group and others ahead of our final plan submission in December of this year. Examples of our consumer and stakeholder engagement led commitments are;

- Make £2m per year available to work with trusted partner organisations, to support the 250,000 customers in our region who are in fuel poverty, by 2028.
- Launch a new £250,000 annual fund to remove barriers that prevent the take-up of low carbon technologies (LCT) with the money targeted at struggling households.
- Proposing to roll out our pioneering 'Street Smart'³ technology to 250,000 customers in disadvantaged neighbourhoods.
- Increase our Priority Services Register (PSR) even further from the 1 million people we already help. The aim to ensure everyone eligible has the opportunity to join and increasing membership so that a minimum of 60% of eligible customers are registered.
- Train all our colleagues to better recognise, understand and support those in vulnerable circumstances.
- Double the amount we spend on partner referral networks to £0.5m a year to establish partnerships with organisations with specialist skills to help our customers who need it most.

14. All these commitments led by our enhanced engagement put customers and stakeholders at the heart of our plans and look forward to this being central to the review and determination by Ofgem in due course.

³ This technology continually makes small adjustments to local network voltage to reduce electricity usage and bills, without affecting customer appliances

15. While we are optimistic that for RIIO-ED2 determinations Ofgem will recognise the benefit of these commitments and the evidence and support gained through enhanced customer and stakeholder engagement we note that some of the discussion from earlier RIIO-2 price controls was that significant elements of customer and stakeholder led ambition/activity was not supported by Ofgem in company settlements. We understand that Ofgem concluded companies' business plans had not adequately justified many proposed steps to support customers in vulnerable circumstances. Ofgem have updated guidance and provided feedback to companies as well as their customer engagement groups (CEGs) and so for RIIO-ED2 determinations we hope the same issues should not occur. This theme was included in PR19 CMA appeals for the water sector where an economic regulator seemed to reject many customer and stakeholder supported wider activities proposed and is now being reviewed by Ofwat as to how this can be addressed as part of PR24 methodology.
16. To address this concern, Ofgem could do more customer and stakeholder engagement themselves and consider how to use other customer and stakeholder engagement insights to inform Ofgem policy positions and decisions. Currently, the consumer research we have seen is somewhat retail focused and updated periodically⁴. Ofgem has a much wider programme of engagement with stakeholders, including with consumer bodies and widely consults on policy, though we think more could be done to use other consumer engagement and for Ofgem to engage directly with consumers in more depth and breadth or for Ofgem to increase its comfort relying on robust engagement done by other entities. More work from Ofgem on understanding customer and stakeholder priorities in the context of networks could be extremely helpful, and provide the context to what its obligations, principles and powers mean in practical terms. This engagement could take the form of Ofgem specific engagement or through working with the DNO licensees as a collective utilising the Energy Networks Association⁵ forum.
17. One area which could be consulted on, or indeed clarified by Government policy/ direction, is the balance of what the role for companies and the sector is for socialised support to customers in vulnerable situations. Particularly this is important when considering that vulnerability can manifest itself in several ways such as fuel poverty. Therefore, Ofgem understanding the subsets of vulnerability in detail through Ofgem led engagement would help to shape policy and ultimately define the roles of companies and the sector in each of the different areas under the headline of vulnerability.

What implications will the transition to net zero have for the security of the UK's energy supply? How does Ofgem currently manage issues relating to security of supply?

18. We welcome that currently Ofgem and BEIS are really looking closely and consulting widely through engagement such as the Future System Operator and industry codes consultation(s) and we note the consultation and response deadline of 28 September 2021. We suggest that Ofgem and BEIS continue to ensure a focus to the challenges being faced as well as on potential institutional reform, though we believe this is currently managed well by both parties. Now is the right time to be considering reforms, due to the likely multiyear timescales for developing and implementing major changes. Major changes do take a long time

⁴ <https://www.ofgem.gov.uk/energy-data-and-research/ofgem-consumer-research>

⁵ <https://www.energynetworks.org/>

to develop and implement so the process for change should be reviewed, including how Ofgem manages it such as through Significant Code Reviews (SCR's).

19. A transition to a Distribution System Operator (DSO) model, which DNOs are ideally placed to deliver many of the DSO tasks has an additional consequence of further enhancing security of supply. Energy issues and the solutions needed are moving to a more local and regional level so collaboration at this level is vitally important with regional energy companies ideally placed to contribute to this. More empowerment and facilitation of regional and local bodies to do Local Area Energy Planning (LAEP) is one aspect that should be encouraged and enabled by Ofgem. Ofgem needs to embrace this with the aim of greater reliance upon regional views in its' decision making.
20. Innovation through new ways of doing things that challenge existing boundaries and thinking is going to be key and will need to be embraced by all stakeholders. An example of this and an ENWL specific activity which provides enhancement of security of supply is our 'CLASS'⁶ voltage control solution which is currently providing services to consumers nationally. Should Ofgem choose to embrace 'CLASS' to help security of supply issues, and if rolled out nationally, it could have prevented a supply issue event like the one observed on 9 August 2019.

Is Ofgem's current system of price controls appropriate? Does it provide sufficient incentives to invest in the context of the transition to net zero?

21. The RIIO-ED1 framework with the strong focus on incentive and innovation is right. This has ultimately delivered strong performance for customers, increased consumer value for money outcomes and significant improvements in customer service within the period. Examples of this are the levels of customer satisfaction increasing from 80% in 15/16 to 91% in 20/21⁷, as well as the interruptions in supply incentive scheme (IIS) which has reduced the number of power cuts by 24% from 15/16, as well as the time duration of these as these reducing by 26% over the same period. So power cuts are now more infrequent and shorter when they do happen. More can and will be done to continue this trend under the right supportive regulatory approach.
22. We are in an important period of agreeing the shape and form of company plans to be delivered in the RIIO-ED2 period and we continue to believe that the RIIO framework (Revenue = Innovation + Incentives + Outputs) is fit for purpose, as long as the central elements of innovation and incentives remain and are not weakened. Reduction in these key elements of the regulatory framework, or an undue focus on short term headline bill reductions or an over focus on affordability concerns, risks the crucial aspects of the RIIO-ED2 regulatory review such as Net Zero transition. We have found our customers and stakeholders are willing to fund Net Zero and support a modest bill increase in our distribution element of the energy bill of £2 per year to deliver our net zero consistent draft plan.
23. Financeability and the ability to continue to attract efficient investment (both equity and debt) in our sector is crucial. Should this not be achieved the ability of companies to manage or react flexibly to uncertainty in the period of RIIO-ED2 will be undermined, ultimately risking outcomes for customers and the sector's ability to meet challenging timeframes on Net Zero transition. By example, as a

⁶ CLASS (Customer Load Active System Services) is a low-cost solution which uses voltage control to manage electricity consumption at peak times.

⁷ To February 20/21.

consequence of Ofgem proposing to set debt financing allowances on a sector average basis this rewards companies with larger debt portfolios or lucky timing to benefit from windfalls. This means that customers in those areas are overpaying for the financing requirements for those companies, as well as the efficient costs of smaller companies being underfunded causing these companies issues of financeability through no fault of their own. We are also concerned about the potential level of expenditure which are linked to uncertainty regulatory mechanisms in RIIO-2 determinations that we saw for gas and transmission companies. Where these can be determined by Ofgem through direction only and without meaningful consultation this impacts investor confidence in the sector and certainty of regulatory settlements. It also risks introducing some delays into meeting consumer need. Ofgem is actively working with the sector to develop processes that is flexible and allow faster decision making so regulation doesn't become a blocker so regulation can remain a strong enabler of Net Zero as it is today.

24. On this and other evidential basis presented to Ofgem we continue to view that Ofgem is proposing underfunding the fair returns needed for the RIIO-ED2 period. For example, this includes the position that the 'aiming down' for returns by the regulator is fundamentally flawed.

25. We continue to remain hopeful that Ofgem will take heed of the discussions and the evidence that many stakeholders have presented and address the concerns raised through its determination in this crucial area of financing the RIIO-ED2 settlement through the setting of the allowed cost of equity and debt. Additional to this, it should be observed that one central element of the Ofgem method for setting cost of equity, namely 'Expected versus allowed returns'⁸ adjustment, was not adopted by Ofwat who saw no need to apply such an artificial adjustment in setting its cost of equity allowance for PR19. Finally, we note that the CMA also has a role in this given the forthcoming findings as part of the RIIO-2 appeal for gas and transmission companies, plus the same route remaining open to any subsequent appeals as part of the RIIO-ED2 process.

Is the current system of governance for the UK energy market appropriate to secure the Government's policy outcomes? What improvements could be made and what role should Ofgem play?

26. As previously set out we welcome that currently Ofgem and BEIS are really looking closely and consulting widely through engagement such as the Future System Operator and industry codes consultation(s) and we note the consultation and response deadline of 28 September 2021. We suggest that Ofgem and BEIS continue to ensure a focus to the challenges being faced now, as well as on potential institutional reform, though we believe this is currently managed well by both parties. Reform could be considered for the future and now is the right time to be considering reforms, due to the likely multiyear timescales for developing and implementing major changes. We would also suggest that this considers wider review remit including potentially retail reform/ improvements.

Are Ofgem's duties and powers appropriate and sufficiently clearly defined? Do Ofgem's objectives conflict and, if so, how should any conflicts be managed?

⁸ Which artificially reduces the calibrated allowed cost of equity by 25 basis points

27. A review of the statutory duties and powers of Ofgem should be undertaken at this stage in the context of Net Zero transition and rapid industry change which we would welcome the opportunity to input to.
28. Further it is important that, should a review be undertaken, it also considers where improved definition is beneficial to clarity and transparency, as well as any removal or addition to the current powers or duties of Ofgem as deemed to be required. An example where improved definition would be beneficial is regarding the duty of Ofgem to financeability which, based on our legal advice, is to the actual company, not the notional equivalent or the sector in general.
29. On policy from Government, we note and are anticipating the forthcoming BEIS consultation on its strategic policy/direction statement to Ofgem and support that it is considered to give periodical reviews and updates to a direction statement given changing dynamics and the speed at which Net Zero is required to occur.
30. An additional aspect which would help inform this process would be an annual transparency report from Ofgem so that all stakeholders are able to review the evidence on how it has gone about discharging its duties and powers. This would also set out a central place by which Ofgem could set out how it has also managed conflicts and trade-offs as part of discharging its duties and powers. This would also form evidence to Government and would support how Government should update guidance to Ofgem based on its annual reporting.
31. We would also support that upfront clear and informed engagement and consultation with stakeholders and companies should continue to be used to manage and identify conflicts when they occur. This could be an aspect of Ofgem activities that are strengthened. We accept that conflicts do occur and are likely to occur potentially more frequently in the future and therefore transparency of decision making and balancing these conflicts with due consideration being given to the impacts identified by all sector stakeholders is of ever increasing importance (for example Net Zero and affordability).
32. With regards to clarity of existing duties, one area which is likely to require additional guidance or input from Government policy is the issue of intergenerational fairness and this balance in terms of who contributes for the delivery of Net Zero transition. This is clearly a complex issue, given issues of affordability, the speed of which transition is required and the context of long lived assets and infrastructure, but currently this has not been sufficiently addressed. An example of where this is manifesting itself is the access and significant codes review (SCR) led by Ofgem which is currently ongoing and is a key input to companies planning, delivery and charging in the RIIO-ED2 period. A strong policy direction from Government on this issue, considering the balance of intergenerational fairness and Net Zero transition would be beneficial and remove this issue as a potential blocker or anchor to the speed of transition.

Is Ofgem's relationship to Government and Parliament appropriate? Are there issues related to the split of responsibilities, transparency or accountability?

33. As a non-ministerial government department and an independent National Regulatory Authority, it is important that this is maintained through independence of decision making guided by comprehensive and detailed Government policy and statements of direction.
34. Given that the split of responsibilities and accountabilities is reasonably clear currently this is achievable. However, the transition to Net Zero and the other

challenges facing the sectors could likely blur these lines in the future. This is because of the fast pace of change expected given the timescales of Net Zero delivery, as well as the solutions and inter dependencies becoming more intertwined and of ever increasing importance. Therefore, Government policy should have cognisance of impacts of regulatory framework and its ability to deliver in timeframes set out and vice versa as the impacts of both policy decision from Government and regulatory framework decision are likely to be two way in the future. Changes being consulted on right now by BEIS (e.g. FSO and Codes reform) means any new roles and accountabilities will need to be carefully positioned to fit with BEIS/Ofgem activities and those of others.

35. We currently observe good co-ordination between BEIS and Ofgem, our view is that more of this best practice can be translated between and to other Government departments. Given that Net Zero addresses varying aspects of our lives such as electrification of transport and transition of heat policy, coordination between all Government departments is crucial. A good example of where this is growing in effectiveness is DFT and BEIS collaboration in Office for Zero Emission Vehicles (OZEV). Therefore, we would like to see more collaboration and coordination across Government of this ilk ensuring timely and coherent policy setting is achieved so clear direction and context for Ofgem can be set in advance of regulatory decisions or framework development.
36. Additionally, given that Net Zero requires both input from policy makers and outcomes from companies and other stakeholders', collaboration, transparent communication and discussion between Government, Ofgem and other stakeholders is vital.
37. Ofgem's Net Zero Advisory Group (NZAG) is an example of a cohort which is made up of good representation, but we are concerned about the transparency of this group and what output/ outcomes are coming from the group currently. For example, the latest minutes on the Ofgem website are particularly concise and with no date for the next meeting of NZAG provided. It is therefore difficult to understand what the outcome of these meetings are and how it is informing Ofgem decision making. A review and revision of the terms of reference is likely needed as the group is currently not fully effective, but to reiterate we see its creation as a step in the right direction in collaboration and coordination terms. We'd like to see this groups effectiveness enhanced.

How does Ofgem compare to similar bodies internationally? What lessons can be drawn from the experience of other countries or jurisdictions?

38. We don't have specific examples to provide, but agree and welcome Ofgem doing reviews of comparable sectors and the forms of regulation elsewhere to understand the lessons that can be learned and deployed by Ofgem to improve outcomes for customers.
39. We also note and support the active role Ofgem has in the forthcoming UN Climate Change Conference of the Parties (COP26) event in Glasgow this year.
40. Further to this, any lessons learned should not be limited to just international comparison but also consider other regulated sectors within the UK (such as water) for examples of what best practice regulation is. We would also note that the UK Regulators Network (UKRN), as well as decisions/ findings as part of CMA appeals are also good resources to consider the lessons that can be learned and applied to Ofgem regulation.

Are there any other aspects of Ofgem's work that the Committee should consider?

41. No response.

18 August 2021