

# Ofgem RII0-2 Framework Consultation

## Response from the Energy Intensive Users Group

### General Comments

*The Energy Intensive Users Group (EIUG) represents the UK's energy intensive industries including manufacturers of steel, chemicals, fertilisers, paper, cement, lime, glass, ceramics, gypsum, aluminium and industrial gases. These industries depend on access to secure, internationally competitive energy supplies to remain in business. UK industrial network charges are amongst the highest in Europe and a major factor in the disparity in electricity costs which disadvantages UK manufacturing industries that have to compete in international markets.*

*There are a number of key principles that EIUG would wish Ofgem to bear in mind in establishing the framework for the RII0-2 price control:*

- **Maintaining Simplicity** – *the guiding principle should be 'keep it simple', especially in relation to stakeholder engagement, making best use of established forums.*
- **Reducing Uncertainty** – *the price control will coincide with a period of rapid technological change, with all the uncertainties that entails. Moving to a five year period would help, although other reforms are also needed to ensure a better deal for energy users. Different aspects of the system also may require different solutions.*
- **Extending Competition** – *where practical, extending competition is likely to achieve better results than interventions that create or distort incentives.*

*Finally, we urge Ofgem to take great care to avoid policy proposals that risk driving industrial users towards reliance on private wire / off grid electricity islands in order to remain internationally competitive, which would increase overall costs to energy consumers.*

*Responses to specific consultation questions follow.*

### Responses to Specific Consultation Questions

#### Giving consumers a stronger voice

Q1. How can we enhance these models and strengthen the role of stakeholders in providing input and challenge to company plans?

*EIUG welcomes Ofgem's proposals for extensive stakeholder engagement throughout the price control process. It is important that provision is made to ensure that the specific concerns of industrial consumers are properly taken into account.*

*EIUG urges Ofgem to make use of existing links to umbrella groups such as EIUG, user groups such as MEUC, trade associations and Large User Group contacts to engage with relevant stakeholders.*

*We very much welcome the intention to simplify aspects of the RII0-2 process compared with RII0-1. We recognise there is a balance to be struck but, other factors being equal, the simpler the process the easier it will be to engage with industrial users and other stakeholders and to for their concerns to be reflected in the final outcome.*

*As Ofgem is already aware, it can be a struggle for individual users or representative organisations to provide the resources necessary to engage with potentially complex price controls. There are a several key actions that Ofgem can take that would help facilitate the engagement process:*

- *To keep the number, structure and composition of any advisory groups simple and manageable*
- *To provide oversight of the process, clarity on the timing and level of engagement required from the outset*
- *To focus work by providing simple, clear and timely preparatory material to aid consultation by stakeholder representatives and guide discussion*
- *To engage with stakeholders to understand what information they require to be able to engage meaningfully and ensure that stakeholder groups have access to succinct, clearly laid out data for them to assess with sufficient time to enable them to do this.*

➔ *What are your views on the proposal to have Open Hearings on areas of contention that have been identified by the groups?*

*This is an interesting proposal which could prove to be valuable. EIUG believes this is worth considering for the RIIO-2 process. It is important though that any such hearings are sufficiently structured (perhaps with written submissions being made in advance) that they don't simply become an opportunity for public grandstanding or point scoring.*

### **Length of price control**

Q2. Do you agree with our preferred position to set the price control for a five-year period, but with the flexibility to set some allowances over a longer period, if companies can present a compelling justification, such as on innovation or efficiency grounds?

*We note that:*

- *The future is uncertain and challenged by fast technical progress*
- *Technical developments are undermining the distinction between networks, generation and supply, demand side and storage*
- *There are opportunities to let markets reveal costs through auction, rather than trying to predict them on a periodic basis.*

*Consequently, EIUG believes that the concept of periodic review requires reform to allow greater scope to encourage meaningful competition and enable markets to bear down on costs more effectively. Looking ahead for five years is for RIIO-2 will be difficult given the possible impact of forthcoming Carbon Budgets, which are likely to cause significant technical and behavioural change. Two categories of cost require different treatment:*

- *Price controls for SOs whose direct costs are management and investment in people and IT that can be more readily forecast, researched and evaluated*
- *Allowances should be aligned to specific project development and delivery timescales.*

➔ *Do you instead support the option of retaining eight-year price controls with a more extensive Mid-Period Review (MPR)?*

*EIUG does not support this option. As RIIO-1 has demonstrated, eight-year price controls are problematic, especially at a time when all elements of the energy system are potentially subject to relatively rapid change. A more extensive Mid-Period Review would undermine the principle of a fixed price control period and associated incentives, and would risk turning into a de facto four year price control.*

### **System Operator price controls**

Q6. Do you agree with our view that National Grid's electricity SO price control should be separated from its TO price control?

*EIUG supports full separation of electricity SO and TO functions and their associated price controls.*

Q7. Do you agree that we should be considering alternative remuneration models for the electricity SO?

Yes.

Q8. Should we consider alternative remuneration models for the gas SO?

*There should be separation of the gas SO and TO price control.*

### **End-use energy efficiency**

Q10. In light of future challenges such as the decarbonisation of heat, what should be the role of network companies, including SOs, in encouraging a reduction in energy use by consumers in order to reduce future investment in energy networks?

*Other than demand side response to resolve or reduce investment, the reduction in use of energy by consumers through energy efficiency measures should not be driven or incentivised through an extension of the role of System Operators. It is a matter for policy and market providers to deliver end use energy efficiency.*

*It is not clear why network companies should have an explicit role to reduce energy use. Indeed, their prime purpose is to facilitate energy use, not to discourage it. Energy users are already incentivised to avoid unvalued energy use through existing consumption based charging arrangements, and to moderate consumption at peak times, e.g. to avoid Triad transmission or red band distribution charges. In addition, users with the flexibility to do so can provide various forms of demand side response that can reduce overall costs to consumers as a whole.*

→ What could the potential scale of this impact be?

*We believe this could introduce significant risk.*

### **Innovation**

Q11. Do you agree with our proposal to retain dedicated innovation funding, limited to innovation projects which might not otherwise be delivered under the core RIIO-2 framework?

*Yes. However, EIUG believes Ofgem should consider making innovation funding available to third parties, which would deepen competition for funding and encourage a broader innovation portfolio across network management. EIUG believes the innovation fund should include a wider portfolio of energy system projects and could be better aligned with existing government policy and funding schemes.*

### **Competition**

Q16. Do you agree with our proposal to extend the role of competition across the sectors (electricity and gas, transmission and distribution)?

*We agree with the proposal to apply competition across all network sectors for new, separable and high value projects, and to consider the role of system operators in enabling or implementing such models.*

→ What are the trade-offs that will need to be considered in designing the most efficient competitions?

### **Information-revealing devices**

Q29. Do you have any views on our proposal to remove fast-tracking for transmission?

*EIUG supports the proposal to remove fast tracking for transmission, recognising the different situation compared with the larger number of comparators in distribution.*

### **Annual reports/reporting**

Q32. How can we make the annual reports easier for stakeholders to understand and more meaningful to use?

*Stakeholders value information that is straightforwardly presented. There is a preference for clear benchmark indicators of financial performance, costs, overarching benefits and savings for consumers.*

### **Cost of debt**

Q33. What are your views on the policy objectives that we have defined with respect to the cost of debt?

*We agree with the principles that:*

- *Consumers should pay no more than an efficient cost of debt*
- *The cost of debt allowance should reflect the actual cost of debt likely to be incurred by a notionally geared efficient company*
- *The calculation should be simple and transparent*
- *There should be a reconciliation process to share debt cost savings with consumers*

### **Other finance issues**

Q41. Do you agree that we should move away from RPI for RIIO-2 (including for the indexation of the RAV if retained as a feature)?

*EIUG supports the move away from RPI for RIIO-2.*

→ If yes, which of the two potential indices – CPI or CPIH – might be most suitable?

*It is not clear why CPIH would necessarily be a more appropriate index than CPI for network regulation purposes.*

### **Ensuring fair returns**

Q45. What are your views on each of the options to ensure fair returns we have described in this consultation?

*We would be concerned that a hard cap or floor, whilst giving protection against excessive returns, could blunt incentives as limits are approached.*

*Fairer returns can be better achieved by enabling greater competition and third party delivery of network services. This coupled with more extensive indexing of the cost of financing businesses, their inputs and the actual delivery of outputs is likely to achieve better results than intervention which creates and distorts incentives.*

Q46. Is RoRE a suitable metric to base return adjustments on?

*We would agree that RoRE is a potentially suitable metric on which to base return adjustments.*

### **Next Steps**

Q50. Do you have any views on our high-level proposals for timing of RIIO-2 implementation, and on our proposals for engagement going forward?

*We have no comments on the high-level proposals for timing of implementation. We would stress the importance of adequate engagement with stakeholders from the start of the process. It may be necessary to modify some of the intended milestones if, for example, it takes longer than currently expected to finalise proposals for future electricity network charging arrangements, which may have a bearing on the analysis needed as part of the RIIO-2 process.*