



**Ofgem's RIIO ED2 Sector Specific Methodology Consultation
Response from Energy Action Scotland**

October 2020

About

Energy Action Scotland is the national organisation campaigning to **end fuel poverty**. Since its inception in 1983, Energy Action Scotland has worked with partners across public and private sectors to change policy as well as delivering many practical and research projects to tackle the problem of cold, damp homes

Energy Action Scotland's response focuses primarily on those areas that it considers may impact most on fuel poor and **vulnerable energy consumers**.

We have provided opportunities for network companies and other organisations to contribute to the development of the **Scottish Government's Fuel Poverty Strategy**.

Background to this response

Energy Action Scotland has engaged with Ofgem and the network companies to deliver projects which support low income and vulnerable households. The main drivers for our work with the networks are:

- Ofgem requiring networks and energy suppliers to enhance their work on the **Priority Services Register (PSR)**.
- Requiring energy suppliers and Distribution Network Operators (DNOs) to be **proactive** in identifying 'need' and act on the stakeholder and collaborative incentives to trial **new approaches** which have a positive social impact while proving alternatives to conventional network reinforcement.
- Ensuring **exemplar network innovation** projects are developed and disseminated fully and encouraging network companies to ensure fuel poor and vulnerable households directly benefit from these innovation competitions and allowances.
- Encouraging networks to deliver **non-network solutions**.
- Requiring Gas Distribution Networks (GDNs) to **exceed** the previous Fuel Poor Network Extension Scheme (FPNES) **targets** and supporting this activity on the ground.
- Ensuring GDNs provide more **consistent advice** and support for vulnerable households when they have to disconnect gas supply at properties when the boiler is deemed to be unsafe.
- Undertaking research and practical projects to **raise awareness** of the risks of Carbon Monoxide (CO) poisoning and acting on the key links between this and the risk of being in **fuel poverty**.

Summary of our response

Energy Action Scotland **appreciates** the proposed approach in the ED2 price control, especially the **increased focus** on consumer **engagement and vulnerability**. We believe, however, that there are several things that require careful thought:

A Vulnerability ODI and Minimum Standards are the right approach, but DNOs need confidence to invest.

We are pleased to see that there is a clear incentive for working to address consumer vulnerability, with a clear alignment with Ofgem's own Consumer Vulnerability Strategy through the baseline standards. This approach represents a **much fairer proposal** for households than has been taken forward in GD2.

While RIIO GD2 has encountered problems in the draft determinations stage of business plan appraisal with regards to the rejection of many vulnerability Output Delivery Incentives (ODIs), and confusion over the new use-it or lose-it allowance, we believe that a **single ODI overcomes** many of the issues faced, with **added simplicity** and a reduced chance of confusion created in the business planning phase.

However, Ofgem must **take action** to ensure that DNOs have the confidence **to invest** in their vulnerability strategies, given that they will only receive the reward or penalty after the fact. It will require early feedback (at the draft determination stage) from Ofgem on each DNO's vulnerability strategy to give them the confidence that achieving their strategy will result in a suitable reward (or penalty) for them, allowing them to assuredly invest in their proposals. Additionally, Ofgem must include an **assessment** of performance in the middle and at the end of the price control. Without this, and because of the ex-post nature of the incentive, we are not confident that DNOs will fully commit to their plans.

We consider the level of funding proposed for the ODI, at **+/-0.5% of base revenue**, to be a **better basis** for determining investment to address vulnerability than the very low investment found in the use-it or lose-it allowance in RIIO-GD2. We urge Ofgem to reconsider the level of funding within GD2 to be more reflective of the current financial difficulties that households are now experiencing because of the pandemic, learning from the increased incentive in ED2. We believe that there is a need and business case for increasing investment in support for the most vulnerable of consumers.

The vulnerability baseline is a good start, but could be strengthened

While the proposals do allow for significant spend on activities to support vulnerable energy consumers, with clear minimum standards for DNOs to achieve, some of these **standards are too broad**, and we believe that with some small changes, the baseline could be improved significantly. For example:

- Ensuring that Principle 1 includes **minimum standards** for households that rely on Braille or British Sign Language to communicate.
- Ensuring that the **mounting consumer debt** issue is accounted for within the Priority Services Register, through the creation of a **new financial vulnerability PSR flag**.
- Including an **integration standard** to ensure that the PSR works better across sectors, reflective of the Ofgem Consumer Vulnerability Strategy.
- **Guaranteeing** the **inclusive design** of DSO functions by explicitly referring to DSO within the vulnerability baselines, and DSO within the vulnerability baselines.

Strengthen the Commitment to Inclusive Innovation

We support the Network Innovation Allowance (NIA) proposals, especially the restriction of scope to transitioning towards net zero and supporting vulnerable energy consumers. We also strongly support the proposed requirement to assess each NIA project in terms of its **impact on vulnerable energy consumers**, and we propose that this assessment must consider:

- An assessment in terms of equity, by looking at the financial impact on all income deciles
- The impact on customers with different heating types, including but not limited to: Gas boilers; Direct electric heating; Heat pumps; Oil Heating; and Solid fuel heating
- A consideration of impact on different vulnerable groups, including but not limited to:
 - Digitally excluded households
 - Rural Households
 - Different property tenures
 - Households using prepayment meters
 - Households with restricted meters
 - Households that speak English as a foreign language
 - Households with disabilities and medical conditions.

Meaningful Engagement with consumers

We are concerned that all the processes were determined before key consumer-based outcomes and outputs had been articulated, consulted upon and agreed. **Consumers** should have had a **voice** in how their views were going to be recognised. In our view this will have frustrated the engagement with consumers via the RIIO-2 Challenge Group or Customer Engagement Groups. This could have excluded the contribution of those with limited knowledge of network activities.

Where the input of organisations and individuals has been provided through the Challenge Groups or through Customer Engagement Groups there must be a more **transparent process** for how that input factors in decision making. We have seen little evidence that shows that their views have been recognised or valued.

**Full response to this consultation
Overview Document**

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

Yes.

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

We support the proposals to strengthen the RIIO-2 NIA framework. In particular, the requirement to assess the impact on vulnerable customers of all NIA projects is a vital part of ensuring that the transition to net zero is inclusive, where the vulnerable are prioritised and where no-one is left behind. The ENA themselves, in their network innovation strategy document, say within its innovation strategy “Customer benefit should be at the centre of all network innovation activity”.

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

We agree with the proposed approach for setting individual levels of funding. Setting the expectation for justification of allowances in business plans should lead to more coherent innovation strategies, where gaps in provision are identified, and innovation exists to try and fill this need. We believe that this could go one step further and require DNOs to set out the split of their expected funding level between projects that focus on the Energy System Transition, and those that focus on Consumer Vulnerability. This would create an extra layer of scrutiny on innovation, as these levels would need to be justified themselves as part of the enhanced engagement process.

OVQ18 - Do you agree with our proposal to use the Business Plan Incentive to encourage companies to reveal standards of performance higher than our baseline expectations in their DSO strategies? Do you agree we should require, where appropriate, all DNOs adopt these revealed standards?

Yes, we believe that such an incentive structure would allow DNOs to compete with each other on the set of minimum standards that each would need to adhere to, resulting in higher standards for all households. If this is not done, and business plans that go beyond the minimum are rewarded without increasing the baseline for other DNOs, then there is a real risk that there will be an unintentional location detriment with consumers in some areas potentially receiving a much higher level of service than those elsewhere. This would be wholly unfair.

OVQ20 - Do you agree with our proposal to introduce a DSO ODI in which we would, via an ex post incentive, penalise or reward companies based on their delivery against baseline expectations and performance benchmarks? If so, what criteria and other considerations should we take into account in determining whether we should apply a reward or penalty?

We agree with the proposal for a new DSO ODI. We are concerned, however, with the lack of detail on how DNOs will be expected to integrate their vulnerability strategies into their plans to fulfil DSO functions, and if/how they will be rewarded for doing so. This level of integration is crucial to successfully achieving the clear goal to “Embed the approach to protecting the interests of consumers in vulnerable situations throughout a company’s operations to maximise the opportunities to deliver support”, as set out in the Appendix 5 of Annex 1 of the SSMC, as the fourth principle of the baseline standards for addressing consumer vulnerability.

The vulnerable should be prioritised and no consumer should be left behind in the energy system transition. Rewards and incentives should be applied to ensure that everyone is included.

We recommend that Ofgem explicitly state that as part of either the vulnerability or DSO ODIs, a reward can be given for activities that directly promote DSO markets to a wider audience. Ofgem should consider ranking of bids into a DSO market to be done on a sustainability basis, not on a purely financial basis, but one which considers total social and environmental benefits (which might enable higher cost community projects which have significant social value).

OVQ23 - Do you agree with the DSO roles, principles and associated baseline expectations in Appendix 5? Does it provide sufficient clarity about the role of DNOs in RIIO-ED2? Do you think amendments or additional baseline expectations are required?

We believe that if the baseline standards for DSO do not cross reference the principle within the vulnerability baseline to “Embed the approach to protecting the interests of consumers in vulnerable situations throughout a company’s operations to maximise the opportunities to deliver support”, then there is a risk that work on vulnerability and DSO will both be siloed, and the potential for truly embedding will be lost.

We propose that the DSO baseline include references for the expectations that arise from the stated principle within the vulnerability baseline. Ideally, a new principle within the DSO baseline would be added, for example “A DNO to DSO transition that is inclusive”, including minimum standards such as the creation of DSO markets that all consumers can directly benefit from.

OVQ30 - Do you agree with the impacts of our potential Access SCR proposals that are identified in this Chapter? Are there additional impacts that are not identified?

We agree with the impacts identified in the SSMC. There is, however, an additional uncertainty that we believe requires careful consideration as part of the process. Depending on the result of the SCR process, there could be a significant cost for some domestic users to either connect to the network, or to upgrade their connection if, for example wished to install a heat pump or electric vehicle charger. While this could be deemed fair for some network users, it could price some vulnerable and fuel poor households out of the market for these crucial elements of the energy system transition, which we believe would be an unintended adverse consequence for Ofgem, BEIS and the DNOs. This would be to the detriment of those vulnerable and fuel poor households and be unfair.

OVQ34 - Do you think we need specific mechanisms in RIIO-ED2 to manage the potential longer-term impacts of COVID-19? If yes, what might these mechanisms be?

The pandemic has led to the single biggest impact on our economy for 41 years¹. It is expected that the affording energy will become much harder for many more people over the coming years. The impact from coronavirus on household situations is and will be significant. There is a reasonable chance that the impact of this on consumers will be more material than the impact of decarbonisation for the period of the GD2 price control.

We believe that DNOs must prioritise the tackling of affordability in their vulnerability strategies, including expanding on work that is already ongoing relating to provision of, and signposting to, debt advice, income advice, and energy efficiency advice.

There should be a reconfiguration of the current losses incentives, so that the equivalent energy savings that are currently realised via reducing line losses are instead delivered in domestic

properties via the upgrading of white goods, lower cost appliances or upgrades to inefficient electric heaters. The priority should be targeting this assistance to low income households with little or no disposal income, as they can't currently benefit from improved product standards, despite potentially benefiting the most from these energy efficiency gains.

Response to Annex 1 – Delivering Value for Money Service for Consumers

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

Yes, we agree with the proposal to remove this incentive. A new vulnerability ODI will mean a greater focus and level of available funding in supporting consumers in vulnerable situations. We believe that this is merited, as while there are large amounts of excellent work supporting vulnerable consumers, it is an area which generally has received less attention than stakeholder engagement in the current incentive format.

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

Yes. A single ODI where performance will be judged on an ex-post basis with clear baselines that relate to Ofgem's own CVS represents a step change in how to regulate for good outcomes for vulnerable energy consumers, in relation to GD2.

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

While we do not disagree on any of the proposed standards, there are some areas that we feel merit extra attention:

- Within principle 1, there is a standard relating to additional communication needs, which is very welcome. As part of this years' UK Fuel Poverty Monitor², which is produced jointly with National Energy Action (NEA) we found that those speaking English as an additional language faced significant difficulty accessing information and support during the pandemic lockdown. We also found that there were significant deficiencies in the provision of material in Braille and British Sign Language. Ofgem should include both of these formats in addition to the top 10 spoken languages in each DNO area.
- Within principle 2, we believe that two additional standards are warranted:
 1. The creation of a financial vulnerability PSR flag.
 2. A standard relating to sharing PSR information and best practice across sectors.
- Within principle 3 we believe that given the principle is based around achieving an inclusive smart, flexible energy system, we believe that there should be a distinct standard related to the main DNO role in the new system in the form of DSO functionalities.
- Within principle 4, we believe that it is extremely positive to expect as a minimum to have a vulnerability champion at board level

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

Yes but there is still a risk that DSOs will not make investments to execute their vulnerability strategies, if the reward is discounted because of its ex-post nature. Ofgem can mitigate this somewhat through providing a thorough assessment of vulnerability strategies in the business

plan assessment stage, giving a steer to DNOs as to which parts of their strategy may be rewarded and which may not be.

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

Yes.

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

No, DNOs have long had an incentive to reduce the losses on their networks. The cost effectiveness of these reductions has deteriorated with time, as the 'low hanging fruit' has been taken early. At the same time, there has been a clear gap in funding for low income households to benefit from more efficient appliances or white goods. The Government assume everyone has had access to increasingly efficient appliances (via improvements through EU products Directives) and therefore this reduces everyone's exposure to increasing policy costs, paid for regressively through energy bills. Sadly, this isn't the case for many low-income households. The losses discretionary reward needs reformed to incentivise DNO to deliver these energy savings within domestic properties (by replacing energy inefficient appliances or electric heating rather than just focus on line losses). This would be an effective way for networks to deliver positive outcomes but again with a strong social and environmental benefit.

Response to Annex 2 – Keeping Bills Low for Customers

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

Energy Action Scotland broadly agrees with the proposed design of the BPI in ED2, but there are some clear lessons that need to be learned from the process for the other networks and the ESO so far:

Ofgem must, in its draft determinations, set out how they have taken stakeholder views into consideration when making decisions. At the beginning of the work to shape the RIIO 2 price control, Ofgem said within the framework decision that “The Gas and Electricity Markets Authority (GEMA) retains ultimate responsibility to make initial and final determinations, using, among other things, evidence from the enhanced engagement process as a key input.”

It was therefore disappointing that the draft determinations did not transparently make considerations of the enhanced engagement process. We feel that there is a risk that the voice of the customer will be dampened through this lack of transparency, both as representatives of fuel poor households on CEGs, and as stakeholders ourselves who have engaged fully in the process.

Energy Action Scotland therefore urges Ofgem to commit to publishing their full analysis of the plans in draft determinations for ED2, including how they accounted for customer views, in order to give greater confidence in the process. Without this analysis we, and others, cannot properly judge whether Ofgem has made informed decisions as to which parts of the business plan to allow, and which to disallow.

In GD2, it appeared that the mechanism within the BPI to assess the companies' vulnerability strategies had been forgotten, and it was not clear if or how companies could or have been rewarded for comprehensive vulnerability strategies. Indeed, Energy Action Scotland understood that there has been no feedback on strategies that required significant work and consumer engagement and had been required by Ofgem. This cannot be repeated in ED2, where it is more essential, as noted in our answer to OUTQ21, to give feedback on vulnerability strategies in the context of an ex post reward for the vulnerability ODI.

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)?

Energy Action Scotland agrees with the setting of baselines in a number of areas (notably for the vulnerability ODI). We set our view out on this in our answers to questions OVQ20 and OUTQ20 above.

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?

Yes. Energy Action Scotland is particularly pleased that there will be a minimum requirement for stage 1 of the BPI. As stated above, it is essential for Ofgem to give feedback on vulnerability strategies in the context of an ex post reward for the vulnerability ODI.

¹ On 30th June 2020, the BBC reported that the impacts of coronavirus had caused the worst contraction of the UK economy in 41 years. For the article, see <https://www.bbc.co.uk/news/business-53231851>

² <https://www.nea.org.uk/wp-content/uploads/2020/09/UK-FPM-2019.pdf>