**Fit for the future - a new low carbon incentive for RIIO2**

Sustainability First is an independent think-tank and charity. We focus on practical 'public interest' outcomes for the energy and water sectors which can serve consumers, future consumers and the environment fairly.

Since 2000, we have been close followers of successive network price controls. Ofgem's RIIO2 regulatory framework – in consultation – will shape and endorse many tens of billions of new network investment in the period from 2020–28 : electricity and gas; national, regional and local.

The method of agreeing energy network price controls can seem arcane : a prolonged technical process. But outcomes are fundamental - for both consumers, 'future consumers' and low carbon.

Questions of network returns aside, Sustainability First has flagged three major public interest outcomes it will look for from the RIIO2 framework.

First, a clear focus in approaches to innovation funds and to network incentives to deliver better services for energy customers who are vulnerable and / or have additional needs.

Second, development of more meaningful approaches by the networks to stakeholder involvement. Not just during the price control negotiation, but also afterwards in 'business-as-usual'.

Third, and the topic of this blog, the case for a new and explicit low carbon incentive.

A recent Sustainability First discussion paper[1] proposes that serious thought be given by Ofgem, the energy network companies and other groups with a direct interest - environmental, consumer, distributed energy resources - to a **new and explicit low-carbon incentive common to every energy network - to be incorporated into the RIIO2 regulatory framework**.

Of course, significant funds can already be accessed by those networks who wish to trial low-carbon innovation. And, within the current RIIO1 price control framework, a number of incentives are also placed on the network companies to promote a variety of environmental outcomes. But these incentives are relatively fragmented. Perhaps surprisingly, none is designed to focus the networks on tackling the carbon footprint of their geography *in-the-round*.

Our thinking for RIIO2 is that a new low carbon incentive could offer **a clear and unambiguous signal to every energy network company for the decade ahead** on the importance of shaping and facilitating lower carbon outcomes.

Such an incentive could help align network business-drivers with national carbon reduction goals; free-up networks to facilitate and innovate on different approaches to low-carbon delivery – be this via energy efficiency and demand-side programmes, local bio-gas, low carbon heat, new collaborations & partnerships – with regions, cities, communities, innovators. It would sit alongside other important drivers which already shape the network price control framework – for economic and operational efficiency, for resilience, for customer service.

Our paper outlines the **scope** of a possible new low carbon incentive - across low carbon sources, network operation and de-carbonising demand. It looks at the possible **structure of a new low**

[1] **A Low Carbon Incentive in RIIO2. Discussion Paper. Sustainability First. May 2018**

http://www.sustainabilityfirst.org.uk/images/publications/other/Sustainability_First_Low_Carbon_Incentive_in_RIIO2_DIscussion_Paper_FINAL_web.pdf

**carbon incentive,** including to what extent the focus might be 'reputational' or quantitative. We explore three high-level options : **quantified ; qualitative under-pinned by metrics; or, qualitative-only**. On balance, the paper points towards the middle option **– qualitative under-pinned by metrics - as a practical start point - for a RIIO2 low-carbon incentive**. But, with a clear eye to more quantification over time. The approach on the new system operator incentive perhaps points the way.

We recognise that **achieving the 'right design' for a low carbon incentive may prove quite hard** : issues of quantification, measurement & evaluation, demonstrable 'additionality' of outcome, how this new incentive would sit alongside other environmental incentives, impacts on returns, the potential for 'gaming', plus, unintended outcomes, including distributional impacts (if any). Each will need careful thought. Even so, we conclude that **the upside of giving a clearer signal to every energy network on their role in low carbon delivery is a good reason to try**.

To 'test' our proposition we wish to see a wide discussion of three questions :

- Is a new explicit low-carbon incentive in RIIO2, common across the energy networks, desirable *in principle* ?

- What practical lessons from the RIIO1 environmental incentives could help inform development of a new low carbon incentive in RIIO2 ?

- Do we fully understand the pros and cons of different approaches to design of a new incentive - qualitative, quantitative – or a mix ?

Ideally, we would wish Ofgem to initiate some background work - to help answer some of the more technical aspects of these questions.

Energy networks are rightly proud of their place in delivery of critical services. A new low carbon incentive would sit alongside other important drivers in network price controls for efficiency and for customer service. A new strategic signal – which recognises the fundamental role that energy networks will play on low carbon in the decade ahead - would give clear regulatory backing to any network company resolved to become fit for the future.

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