

An 'Umbrella' Low Carbon Incentive in RII02 : Why & How ?

Short brief from Sustainability First¹

Summary

Ofgem's RII02 regulatory framework - currently out for consultation - will shape - and endorse many tens of billions of new energy network investment in the period from 2021–28.

At this initial stage in designing the RII02 framework, Sustainability First is proposing that serious thought be given by Ofgem, the network companies and others with an interest, to an explicit 'umbrella' low carbon incentive, common to every energy network.

Significant funds are already available to networks who seek to trial low-carbon innovation. And, within the current RII01 price control framework, a number of environmental incentives are placed on network companies to promote a variety of environmental outcomes. However, these incentives are currently relatively fragmented and not very visible.

We believe that for RII02, a re-shaped '**umbrella' low carbon incentive** would provide a **clear signal to network companies for the decade ahead.**

It would **sit alongside other important drivers in the network price controls - for economic and operational efficiency and for discharge of their wider societal responsibilities in delivering a critical service.**

Why a Low Carbon Incentive ?

The aim of an explicit umbrella low carbon incentive for the energy networks would be to:

- Give a clear signal on **regulatory backing** for the important role of the networks in shaping and facilitating lower-carbon outcomes across business-as-usual.
- Better **align network business drivers** with whole systems thinking and national carbon reduction goals.
- **Avoid undue prescription** – but reward networks who wish to be flexible, creative and innovative in their approaches to low-carbon facilitation (so, where appropriate, to support cost-efficient low-carbon initiatives such energy efficiency, bio-methane, low-carbon heat or transport).
- **Promote top-to-bottom culture change** – so encourage leadership from network investors & managements on low-carbon delivery.

¹ See our Sustainability First Discussion paper – A Low Carbon Incentive in RII02. May 2018.

http://www.sustainabilityfirst.org.uk/images/publications/other/Sustainability_First_Low_Carbon_Incentive_in_RII02_Discussion_Paper_FINAL_web.pdf

- Better **align the agenda of the networks** – given their geographic footprint – with the low carbon agendas of **devolved authorities, towns, cities and other communities**.
- Within the **current licence framework - enable more creative ‘whole-system’ & cross vector thinking**. Encourage partnership working with innovators and others as DSO models evolve.

Such an incentive scheme seems ‘affordable’, assuming this would be similar in scale to the current RIIO1 environmental incentives - at ~£250m over 8 years - equivalent to around just 0.2% of current network revenues.

At a roundtable we hosted on 31 May 2018 there was interest from a range of stakeholders - including energy networks, energy trade bodies, consumer & environmental bodies, and others.

How to design a new low-carbon incentive ?

If an incentive is linked directly to measurable outcomes on low carbon – and therefore provides a reward which is ‘automatic’ - then issues of measurement will need careful thought. Issues to address might include how to demonstrate ‘additionality’ of low-carbon outcomes, calibration, impact on overall returns - including the potential for unintended ‘windfalls’ or gaming, and, an understanding of distributional impacts (if any).

Our proposal is therefore for a qualitative (i.e discretionary) ‘umbrella’ low carbon incentive – to be judged by a panel - but underpinned by metrics. This would allow the approach to measurement to be evolved over time as experience was gained.

As a start-point, there are already potential models which could be adapted (eg the new electricity system operator incentive structure for 2018-21).

Informed by the RIIO1 experience on environmental incentives, the design of a new ‘umbrella’ incentive could include a mix of qualitative and quantitative elements – including some of the current environmental incentives (eg for SF6) – and assessed in the round by a standing expert Panel. As now, some elements might differ by network sector. We would foresee an approach to evaluation which was robust but not overly mechanistic.

A re-designed RIIO2 umbrella incentive could look across the value chain - at all the different elements of the network companies’ impacts on carbon reduction :

- **Facilitating connection of low-carbon energy sources - and ways to increase output**
- **Low-carbon network operation**
- **Support for lower or de-carbonised demand** – including, potentially, across heat and transport.

Sustainability First sees an umbrella low-carbon incentive in RIIO2 as a practical and ‘do-able’ step out to 2028 – within the bounds of current energy network duties.

It would give regulatory backing to network companies who wish to be more pro-active on low-carbon while allowing some flexibility on their delivery.

What new outcomes might a low carbon incentive drive ?

With a new low-carbon incentive, what *more* energy networks might facilitate or achieve on carbon reduction outcomes will sit with them. But, we could see this reformed incentive starting to address in a small but significant way the ‘square-peg-in-round-hole’ challenge for those who wish to drive new and inventive approaches on low-carbon into network thinking and activity, including for whole-system or cross-vector.

What are the RIIO2 alternatives ?

The RIIO2 Framework will set the shape of network investment and activity for a decade, out to almost 2030. **RIIO2 needs to give a clear signal on lower carbon as one significant and desired outcome of the RIIO2 process.**

The benefit of explicitly flagging the importance of low-carbon delivery by the energy networks for the decade ahead is self-evident. An umbrella low-carbon incentive is one way to do this. And if not, then what might an alternative framing might look like ?

Next steps

Sustainability First wishes to see a wide and informed discussion on how RIIO2 can be used to help drive the low-carbon transformation across the energy networks.

Re-framing the current RIIO1 environmental incentives - into an ‘umbrella’ low-carbon incentive for RIIO2 - could be a key part of this drive – along with a review of the criteria by which Ofgem will assess the initial energy network business plans for the RIIO2 process.

We are keen for the energy network companies - together with the regulator, government, the energy trade bodies and others with a particular interest - to actively engage.

As a start point, we believe it would be helpful for Ofgem to consider:

- **In RIIO1** – raising the profile of current environmental incentive outputs, including a review of current reporting arrangements.
- **For RIIO2** – signalling in their Framework decision document expected in July 2018, the importance of low-carbon and a wish to explore an umbrella incentive common to all the energy networks, and to take this forward when they consult in late 2018 on strategies for each network ‘sector’ (transmission, distribution, electricity and gas).
- **For RIIO2** – in the design and structure of any new umbrella low carbon incentive – exploring the balance of qualitative and quantitative approaches.

Sustainability First.

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