

Sustainability First Response to Tom Wood, Ofgem

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Dear Tom

RIIO2 - Net-Zero Reopener

Sustainability First welcomes the opportunity to respond to your open letter of 5 May circulated to members of the ED2 Over-Archiving Working Group in which we have been participating. We welcome Ofgem's steps to enable a more 'adaptive' regulatory regime with respect to net-zero and the creation of a new Net Zero Advisory Group with a role to ensure better strategic alignment of decarbonisation policy and energy regulation.

It is clear that there are a number of elements of the government's policy for reaching net zero that are still in development and which could have material impacts on the outputs that the networks need to deliver through the RIIO2 timeframe.

In most cases one would expect that the impact of such policy changes would be reflected in changes in electricity load or demand levels for low-carbon technologies that should be covered anyway by volume drivers, recognising that there is an inherent high level of uncertainty in these projections which the RIIO 2 framework will anyway have to accommodate.

However, it remains possible that there will be other sorts of changes that by their nature or scale cannot be addressed through volume drivers within the fixed 5-year RIIO2 price-control period. It would therefore seem appropriate to have a broader net zero re-opener to ensure that companies can be funded for significant new activities that may be required. It is also important that consumers do not pay unnecessarily if, for whatever reason, costs already agreed can be significantly scaled back as a result of wider changes. However, this reopener mechanism should only be used in exceptional circumstances in order to avoid undermining the regulatory certainty that the RIIO framework provides.

Examples of situations where it might need to be used are likely to be few and far between. They might include new legislation or new policy where there is a clear requirement for additional action by the networks (or system operators) not reasonably foreseen at the time of RIIO2 Business Plan submission or by the regulator at the point of price-control determination. Any such change would need to be material to trigger a re-opener and potentially to have a cross-sector, cross-vector or whole-system dimension not already reflected in the uncertainty or cost mechanisms for each sector methodology. For example, an acceleration or slowing of the statutory target for net-zero could have such an effect. By contrast, any material change to heat policy impacting gas network capex could be dealt with via the existing GDN RIIO2 heat-policy re-opener.

SSEN presented at a previous OAWG a framework for thinking about where different uncertainty mechanisms should be used. Where the uncertainty was around volumes the appropriate mechanism was a volume driver. Where the uncertainty was around cost (because of the unknown nature of the technology or action required) then a reopener was the right approach. This

framework appeared to have broad support in the OAWG and should inform the approach to developing the methodology for the net-zero reopener.

We have set out below our views on the specific questions raised.

1) What types of event or change do you think should trigger the net zero reopener mechanism?

As proposed they should be material and should allow for both increases or decreases.

Events that result in changes in volumes ought to be able to be handled through volume drivers which provide more certainty.

However, there may be other changes (eg to the connection boundary, to government funding of innovation projects, possible major new requirements for EV charging which involve radically different technical approaches to those already agreed) which could have material impacts on the networks. By definition they are things that cannot be anticipated now but they could be driven by changes in government (or Ofgem) policy, technology or market developments. Equally there could be changes to volumes (as a result of changes to net zero targets – at a national, regional or local level - or to carbon budgets, for example) that are on such a material scale that the volume driver is no longer considered appropriate.

There is also a question about whether there should be a cut-off date – it seems unlikely that it would be worth re-opening the control in year 5 for example. That said it may still be worth allowing that flexibility while making clear it is very unlikely to be used, rather than specifying a somewhat arbitrary cut-off date in licence.

2. What types of changes to licences do you think the net zero reopener mechanism should provide for?

To adjust outputs or revenues.

3. What process do you believe we should we follow under the net zero reopener to determine whether changes to companies' licences are needed (and, if so, to determine what should those changes be?)?

Any process would need to be relatively rapid given the overall timeframe for the price control – which is why volume drivers defined in advance are strongly to be preferred.

The involvement of the NZAC in the process is important to ensure that the effects of government policy are considered in the round and also that the changes are seen as genuine shifts not simply special pleading by the companies.

4. Do you have any comments on the introduction of a net zero reopener as it may relate other uncertainty mechanisms and, do you think any changes are necessary to the design of those mechanisms? For example, the CAM, as mentioned above.

As noted above volume drivers should be preferred – but one design change could be a trigger level for LCT volumes (if they are covered by a volume driver) where a deviation at a certain level would engage the re-opener.

For gas it seems likely that the heat policy reopener would cover most eventualities and it is less clear that the net zero reopener is needed. If both mechanisms are included then clear pre-agreed criteria are needed as to which route would be used in different situations.

With best wishes

Yours

Maxine

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