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Dear Joe

Ofgem's Decarbonisation Programme Action Plan

We are extremely pleased that Ofgem has now published its Decarbonisation Action Plan. This is an important step for the organisation and is to be warmly welcomed.

We hope that the comments below are helpful as you start to turn the plan into a set of concrete actions. We will be meeting Jonathan soon and look forward to discussing the points we raise, and how Sustainability First may be able to assist with this work, then.

Sustainability First welcomes the fact that the Decarbonisation Action Plan successfully pulls together numerous workstreams and recognises that net zero requires a more holistic regulatory approach. This will help all sides prioritise and plan their work and should tackle issues of sequencing and choreography.

In particular, we are pleased to see the recognition of the importance of ensuring that the cumulative costs and benefits of these initiatives fall fairly between different groups of consumers. A point flagged in Sustainability First's What is Fair? paper last September.

We fully support the call for government clarification of its social and environmental guidance. Big decisions around who pays for net zero – and whether costs are best recovered through bills or taxes – need to be taken by those with a clear democratic mandate.

As Jonathan said in his speech on 11th February, the challenges of decarbonisation are not primarily technological but more around who pays and when; the balancing act. Sustainability First's Fair for the Future project, which Ofgem is sponsoring, has been exploring how best to address the politics of fairness and the environment and should be helpful as you think about how best to do this.

Ensuring a just transition is going to be a considerable strategic challenge over the decades ahead. How we get from A to B and ensure that interests are balanced in a fair way in the process, is not 'in the bag' and will require considerable attention. We would note that even if Government commits to address the issue of who pays for decarbonisation through taxation, there will still be a significant amount of work for Ofgem to do to understand the distributional impacts of regulatory decisions. We are keen to work with Ofgem as it develops it's thinking in this area, particularly in terms of inter-generational impacts.

We are very pleased to see a focus on adaptive regulation. The proposals for network price-controls - for a net zero 're-opener' and strategic innovation fund - start to set out what this could look like.

There are several areas, however, where we consider the plan could be strengthened.

1. **Monitoring, reporting, evaluating and demonstrating impact**

   Net zero is a 'long-haul strategic challenge' and milestones along the way are vital. Although we appreciate the extent of uncertainty, the plan is short on dates and any indication of how Ofgem will assess its impact in this area. Setting some markers for when different decisions need to be made (without picking winners or being prescriptive about the process etc) would be a helpful first step.

   Sustainability First has argued hard for consistent approaches in RIIO2 on environmental reporting - for the sectors and companies – to give assurance on how far companies and Ofgem are monitoring emissions reduction and therefore 'getting it right'. Without such an evidence base *and* sector wide analysis (eg do individual company plans look sensible? Are they consistent? etc), it is difficult to assess whether the scale and pace of change are sufficient. The plan is silent on the role of environmental reporting as a basic building block in progress towards net zero.

2. **Enabling more regional approaches**

   Although the plan recognises the importance of regional approaches, Sustainability First considers that it needs to go further in this area. More detail is needed on how the regulatory model will change from being essentially top down to recognising the increasingly decentralised nature of the energy system and the potential role of local solutions.

   This needs to take account of technology (local generation and flexibility services etc) *and* local needs and preferences. The latter will require going beyond 'touring board meetings' and local customer immersion sessions, useful though these may

be, to a more fundamental consideration of how Ofgem restructures itself and systematically approaches its work in this regard.

The RIIO price controls will be key for putting thinking in this area into practice. Rapid progress towards a net-zero and decentralised world, and a smooth and cost-efficient energy transition will require significant new collaboration and coordination at a regional and local level.

Sustainability First has argued strongly for a new incentive to recognise a DNO regional leadership role - to promote outcomes on regional, community and local approaches to energy balancing and supply. The assets and geographic footprint of each electricity distribution network constitute a major 'public good'.

We consider that DNOs should be appropriately incentivised on specific outcomes for a regional leadership role, to:

- Step-up to a bigger regional role on low-carbon facilitation and green growth and development;
- Demonstrate specific outcomes in support of regional- and community-energy; and
- Catalogue major barriers to regional, community and local delivery – including where DNOs or DSOs have agency to 'unblock' steps needed.

Ofgem's Decarbonisation Action Plan recognises some of the complexities around aligning responsibilities and democratic mandates in this area: "*Where localities or regions have secured or made early commitments, the long-term costs will be reduced and/or the risk that assets will be stranded is also reduced. Boundaries of network companies do not fit neatly with local and regional government structures. Where costs are socialised broadly within an area of democratic accountability, we may be able to support proposals for additional funding, for example through network price controls. But where funding needs to be cross subsidised from outside an area of accountability then the trade-offs may be different and our decisions will, where appropriate, need to account for this*."

Further discussion around this and what it might mean in practice is needed – recognising the fact that democratically elected local authorities, transport authorities, universities etc may be too stretched to proactively engage on these topics. Thought is needed as to how to build the capacity of these groups to enable them to do this and to ensure that engagement is as easy as possible (eg webinars, piggybacking on existing conferences that they may be going to etc).

3. Getting an appropriate balance between electricity and gas and the need to reduce carbon stocks / emissions now

The plan is more focused on electricity than gas. One of the few new policy decisions included is that Ofgem will be asking HSE to review the gas mains replacement programme given the likely decline in demand for gas. Given there are very strong arguments for mains replacement to reduce methane leakage and to create a hydrogen ready network this is a strange policy to include. What it suggests is a presumption that electrification is the way forward on heat which is a policy call that has not yet been taken.

Science makes clear that it is the cumulative carbon emissions that matter ("it's about stocks not flows"). That means there needs to be at least as much focus on what can be done to reduce emissions now as there is on the endgame. This point is totally lacking in the plan; there are no reference to driving reductions in methane on the gas side or SF6 (sulphur hexafluoride) on the electricity side. These come within the list of targeted greenhouse gases that Ofgem acknowledges it needs to worry about and have higher global warming potential than carbon dioxide.

A cross-sector plan and reporting is needed is on SF6 - and how this will be tackled to hit net zero – in RIIO2. Any such cross-industry SF6 plan would need to cover transmission and distribution and:

- Support an industry-wide strategy on new equipment;
- Clearly prioritise what switch-gear equipment to replace and when;
- Tell a convincing story about why Transmission is a main priority but recognise the volume issue associated with DNOs (number of switch gear units);
- Coordinate with: the CCC carbon budget trajectories; other sectors (eg rail); (EU/international) supply chain etc; and
- Consider consent/planning constraints on replacing existing small SF6 units with larger-sized switch-gear on small city / constrained sites.

4. Getting the right culture in place to navigate through uncertainty

The plan rightly notes that decarbonisation requires trade-offs. But net zero is not just about justifying new strategic investment. It could helpfully say more about encouraging the shift in mindset and culture that delivering on net zero will require.

This is vital if companies are to make the 'right' judgements in the face of significant disruption - and to move away from more prescriptive regulation. It is also a potentially missed opportunity. Investors are starting to demand more on decarbonisation and taking a greater interest in 'ESG' ('Environmental, Social and Governance') reporting. A clearer alignment by Ofgem with the responsible business agenda could amplify the impact of the Plan.

We do not underestimate the importance of pulling the harder levers of policy and regulation to deliver decarbonisation. However, overlooking these softer levers

could have a cost. Values, corporate and regulatory behaviours and relationships, meaningful community engagement and collaborative approaches are notable by their absence in the Plan.

These softer levers become more important as the demand-side really starts to flex and energy as a service develops; and when all sides have to cope not just with mitigation but also adaptation. When extreme weather brings the wires down or floods a substation, behaviour and relationships are key to recovery, public understanding and tolerance.

5. Ensuring customers in vulnerable situations are not left behind in the transition

Work is needed to explain how this will be done given shifting patterns of disadvantage in a warming world. The Plan implies that vulnerability will be treated in a separate workstream to Ofgem's decarbonisation work. If this is the case, opportunities for 'smart inclusion' for those who cannot flex (eg don't have EVs, are private renters and can't install smart kit etc) may not be fully integrated into net zero agendas. Moreover, consideration of smart inclusion extends beyond household customers, to others at risk of being left behind in the transition. For example, certain business segments or particular regions.

The plan does not explain what Ofgem is doing to identify what the future touch points of customers in vulnerable situations may be under different decarbonisation scenarios. Without this analysis, it is difficult to target support and prioritise actions.

6. Transparent, robust and joined-up decision making and governance

To build trust and confidence in the transition, it will be important to make the role and remit, terms of reference, membership expertise, key data points / sources of analysis etc of the proposed Net Zero Advisory Group clear. Getting this right, and providing adequate support for this group, will be crucial if this is to be successful. There are useful lessons to be learned from the Ofgem Challenge Group process here.

Given that one of the key challenges that Jonathan has highlighted will be the balancing of different interests, being able to explain at a corporate level how the social agenda, including but not limited to vulnerability, will be brought together and integrated with the environmental agenda around decarbonisation, will be important.

If the only place that this comes together is the Board, this could present problems down the line in terms of being able to explain how trade-offs were dealt with and the basis on which key decisions were made. The Board will want to consider how it fulfils its sustainable development duty in this context.

Just because steps to integrate advice in these different policy areas have not always been completely successful before, doesn't mean that this shouldn't be tried in future arrangements. As the UN reviews 5 year progress towards achieving the UN Sustainable Development Goals in June this year, the government will want to know how sustainability is being mainstreamed in the UK context.

Lastly, for justifiable reasons, the Plan focuses on what Ofgem itself can do. Ofgem is clearly extremely aware that the decarbonisation of electricity will enable many of the cross-economy changes that will be needed to deliver on net zero. The need for joined-up approaches between sectors, not to mention circular business models, is likely to grow.

It would be helpful to explain to stakeholders what role Ofgem will play in facilitating cross sector change with other regulated sectors in this area (eg sharing expertise, secondments, joint working groups etc).

Best wishes

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