Reference
Ofgem Access and Forward-looking Charges Significant Code Review: Consultation on Minded to Positions

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Cadent
Your Gas Network

Dear Mr Patrick Cassels

Ofgem Access and Forward-looking Charges Significant Code Review: Consultation on Minded to Positions

I am writing on behalf of Cadent Gas Ltd in response to Ofgem's consultation on minded to positions on access and forward-looking charges published on 30 June 2021.

Cadent owns and manages four of the eight gas distribution networks (GDN) in the UK. Our pipes carry gas to 11 million homes, schools, hospitals and businesses in the North West of England, the West Midlands, the East of England (including the East Midlands and East Anglia) and North London.

Cadent are firmly committed to playing our part in the UK's transition to Net Zero by 2050 and is leading the way in developing the green gas and hydrogen infrastructure we will need in order to get there, alongside increased electrification. We recognise to deliver these, however, will require comprehensive reviews and reforms of existing charging regimes and industry codes. We therefore welcome Ofgem's review into forward-looking charges for electricity as a step forward, but also note that more action is needed urgently across both electricity and gas to enable the transition.

Notwithstanding the need for further action, in respect of the review itself it is important that Ofgem adopts a whole systems approach to recognise the implications of potential reforms across the wider energy system. Ofgem have recognised the need for whole system thinking across electricity and gas more broadly. For example, in its Forward Work Programme 2021/22 and recently issued RIIO2 business plan guidance for Distribution Network Companies (DNOs). However, more consideration could be given within this review (and those in future), with perhaps the addition of a further 'guiding principle' for charges 'to understand potential whole system impacts'.

We note that in the consultation there is focus on ensuring implications across electricity distribution and transmission are factored into decision-making. However, it is also paramount that reforms in electricity take account of any precedent and impacts they could have for gas. Otherwise, changes made may potentially, and unintentionally, distort future decision-making and incentives for the evolution of gas networks to support green gas and hydrogen.

One of our biggest concerns is the wider implications of the changes set out in the consultation. As the impetus for the review of charges is removing barriers to Net Zero, to support a whole systems approach, it is important any proposed changes only apply where the electrification choice is likely to be the best option to deliver Net Zero. This is clearly not the case for homes switching from gas to electricity, because the best course of action to Net Zero is yet to be determined. Any decision with relation to heat should not presume an answer that one method is the best, as this could close off other

potential credible futures, and sends a misleading and incorrect signal to consumers. Thus, in the absence of a decision on heat policy, it would be our recommendation that Ofgem should only propose these changes for new build and potentially off gas grid homes, where electrification is likely to be the strongest option. It should not be applied to uprating the electrical connection of existing homes and businesses seeking to convert from gas. Furthermore, if switches away from gas are signalled, ahead of heat policy, it could result in increased bills for gas consumers from the reduction in the number of customers.

The consultation also references the likely important role of electric vehicles (EVs) and heat pumps in meeting the government's targets for the electrification of heat and transport. The Government's Ten Point Plan laid out the ambition to achieve 600,000 heat pump installations per year by 2028. However, Ofgem have not elaborated any further to make the case for how this charging policy supports the least cost delivery of the government's targets, without which it is difficult to judge if this is the best way forward considering the wider picture.

Aside from the above, in general, we agree with the overall approach and principles outlined for changes to charges set out in the consultation. Furthermore, we are broadly supportive of Ofgem's proposals, particularly in relation to connection charging for generation as this would mean a move towards a shallower charging policy through recovering reinforcement costs from a wider body of consumers. This will reduce the upfront cost of new connections and incentivise growth of low carbon energy production which is needed across both electricity and gas to support the transition to Net Zero. We will be considering how this applies to distributed gas entry connection reinforcements, as there is clearly a direct read across.

In determining how a shallower connection charging policy is applied in practise, however, will require further work. The consultation document itself notes that changes to Distribution Use of System Charges (DUoS) are currently being considered, but does not provide any further details. We think it is unreasonable to consult on views on a change to the connection boundary without providing a view on how the costs being moved into DUoS will be treated. While the consultation takes a worst case scenario, as it stands, it is difficult for respondents to provide a considered and balanced response without knowing the impact on each class and/or type of customer. For example, a customer that avoids an upfront cost of connection, may end up paying more over a longer period following a revision to DUoS charging.

As a shallower policy will seek to recover greater levels of costs from consumers, it's clearly important that this is taken into account for changes to DUoS. Specifically, to ensure the right balance is struck to encourage efficient capacity provision, whilst ensuring charges are cost reflective for consumers to encourage the right behaviours. Otherwise, changes made to make connection charging policy shallower could be 'undone' by potentially inconsistent DUoS changes.

Relatedly when looking at Ofgem's arguments on price elasticity for example, which would support stronger DUoS signals, a drawback is that it considers only a single buying decision to install EVs or heat pumps and only at the point of purchase. But the consumer would also need a strong cost signal when a replacement decision to change their car or heat pump is taken in the relatively near future. Moreover, a lack of a view presented on the DuoS changes makes it difficult to see how the changes will help in regard to strategic investments. Greater clarity is needed on how the proposed changes will help DNOs make strategic investments ahead of need.

We appreciate that cost reflectivity and competition/removing barriers to entry are important drivers for the change. However, it is imperative that the trade off between the two competing drivers is addressed appropriately, not only in electricity, but also in gas. For example, if Ofgem conclude there is a shift required towards removing barriers to entry, then this needs to be reflected and recognised in the governance in gas and electricity, and across transmission and distribution. There may perhaps be scope for

Ofgem to introduce a new objective regarding Net Zero that complements cost reflectivity and the promotion of competition. Similarly, if the socialisation of costs is the preferred direction in electricity for large scale changes it should also apply in gas to maintain consistency and support integration as part of a whole systems approach.

On a further note, Ofgem convey the importance of incentivising the DNOs to explore flexibility instead of installing firm capacity. Taking this route makes sense initially and could help to save money. However, unless the flexibility is guaranteed for a long period of time into the future, a point will be reached where firm capacity will be required, potentially arising when the network has been distressed. Unless the DNOs are taking the risk of having to build the asset at some point, they will potentially be remunerated twice, once for the flexibility service, and later for the asset. This creates a potential inequality when comparing decarbonisation options, if the electrification route, is assessed to be initially cheaper due to the later asset upgrade not being included.

We would welcome further work on how proposed changes in this consultation can read across to gas and would be interested to know whether Ofgem are considering a similar significant code review in gas. We would also be more than happy to discuss our response and any areas of our response further.

Yours faithfully

Sam Hinds
Head of Regulatory Economics

By email