

7 June 2022

Call for Input: Future of local energy institutions and governance

Thank you for the opportunity to respond to your call for input regarding the future of local energy institutions and governance. This response represents the views of Northern Gas Networks (NGN).

In addition to this response, NGN has discussed and reviewed the consultation with other energy networks and the Energy Networks Association (ENA) and contributed to the development of the ENA response. NGN strongly supports the submissions of the ENA and other gas distribution networks to this consultation, who have highlighted several points of view, akin to its own.

We have responded to each of the questions outlined in your consultation document and offer the following general thoughts that we consider need to be addressed to ensure a framework that is able to deliver a whole system approach is implemented.

NGN in general supports the concept of establishing local energy institutions and governance and considers that, in principle this is a pragmatic approach to ensuring that a joined-up gas and electricity energy system is operated and maintained to efficiently deliver the required outputs and outcomes of a net zero energy system in the UK. We also note the intention to deliver any reform with minimal disruption which we agree is in the best interests of customers.

We note that much of this consultation focuses on Energy Networks, however, agile regulation and policy is required for the whole energy system, to ensure clear roles and responsibilities, aligned goals and to mitigate potential conflicts of interest.

To enable whole system outcomes, we consider that there is a need for regulation to shift towards more a collaborative approach between actors, rather than competition, to deliver the best outcomes for customers. To achieve Net Zero, the institutional and governance arrangements for networks need to be far more collaborative than ever before, and the supporting regulation must reflect this.

We do not consider that the consultation adequately considers the long-term future of gas. Whilst we recognise the inherent uncertainty of the future of the gas network, the framework that is established for the governance of any local energy institution needs to more effectively outline how gas will be accounted for and assess the best short- and long-term options to ensure customer and stakeholder interests remain at the heart of any future operating model. Based on the models presented it is not entirely clear that the most optimal outcome has been identified. The current model addresses gas at a high level but lacks the depth of an integrated whole system approach at the lower levels. We do not consider that this is the most beneficial solution to deliver consumer value over the longer term and cannot see where the wider market issues associated with gas being a part of the future energy system are addressed and will be incorporated into the framework. This must be considered upfront as a part of the proposed solution and not an afterthought to be bolted on at a different point in time.

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1. Are the three-energy system functions we outline (energy system planning, market facilitation of flexible resources and real time operation of local energy networks) the ones we should be focusing on to address the energy system changes we outline?

Yes, at a high-level, we broadly agree with the functions highlighted in the consultation. These appear to be consistent with what Ofgem outlined in its RIIO-2 Business Plan guidance. However, while the functions seem acceptable at a high-level, the next layer of detail in terms of definition, scope and interactions is unclear. For example, there is no description for how these functions would be applicable to Gas networks, adjacent sectors (e.g. transport) and other actors (e.g. aggregators, suppliers, etc). There is also no description of the impact on customers and how this would be taken into account, particularly those in vulnerable situations.

Specific comments on the functions:

- Energy system planning – must also include the customer angle, especially vulnerable customers and include a clear approach on local area energy planning with clear roles, responsibilities, governance, and funding arrangements. The approach must also look energy networks and consider adjacent sectors such as waste, telecoms, transport, water, heat, etc .
- For market facilitation -the role of supplier in ensuring that they accurately and fairly reflect price signals down to customers must be considered and better co-ordination is required across all energy markets, including DSO and ESO markets
- For real time operation of networks – the customer angle is missing from the consultation. Gas Networks operators already manage the gas system in real time, and it needs to be considered whether this is practical or indeed required at all voltages and pressure tiers across Gas and Electricity networks.

2. Do you agree with the criteria we have set out for assessing the effectiveness of institutional and governance arrangements?

Yes, we broadly agree with the criteria listed in the consultation. However, there are additional criteria that need to be considered for assessing the effectiveness of the governance arrangements. These additional criteria include costs (including transition costs to change governance), time (including the amount of time taken to transition, and interaction with wider government timelines for net zero related activity) and complexity in changing, noting that this is directly linked to the previous two criteria.

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3. Do you agree with our assessment of how far the current institutional arrangements are, or are not, well suited to deliver the three key energy system functions?

Under the current arrangements, networks have been able to deliver several positive step changes towards delivering against net zero targets and the UK currently operates a world class energy system. However, further iterative changes are required to capitalise on work done to date. Coordination and cooperation across electricity and gas networks, as well as Local Authorities and all other players in the energy sector, will be fundamental to achieving Net Zero. Coordination across markets will be similarly critical to operating an efficient zero carbon system.

It is highly unlikely that one institutional change will enable Net Zero. In addition to regulatory change, agility from an institutional arrangement's perspective is required. There will likely be multiple changes in governance and institutional arrangements required between now and 2050, which will be triggered by different policies and industry trends. As such, an iterative approach to governance and changes to institutional arrangements would be more suitable. In taking this iterative approach we need to be careful that decisions made earlier on, do not put the UK on a high-cost irreversible cost pathway.

4. Overall, what do you consider the biggest blocker to the realisation of effective energy system planning and operation at sub-national level?

There are a range of blockers in realising effective energy system planning and operation at sub-national level, these include:

- Absence of fast-paced and agile decision making which is essential in ensuring that funding is made available as-and-when required, as well as making sure that governance changes do not inadvertently restrict progress on achieving Net Zero objectives.
- No clear policy direction and framework for local area energy planning.
- Lack of clarity on roles and responsibilities at a whole system level, especially regarding the role of local authorities in decision making.
- Lack of flexible funding/resources for networks and Local Authorities.
- Conflicting or absence of appropriate incentive mechanisms for gas and electricity operators to collaborating to deliver net zero objectives in a whole system planning approach.
- Lack of skills and resource to deliver net zero objectives.
- Insufficient network charging mechanisms.

5. Do you agree with the opportunities of change we outline and the potential benefits they may create?

Yes,

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To achieve Net Zero, there need to be clear roles and responsibilities to ensure that all actors work together in a fast and highly organised manner. We consider that maximising functional synergies, where they can speed up decision-making and reduce costs, is inherently sensible.

The most valuable opportunities exist from a whole systems perspective. Enabling, enhancing, and incentivising coordination and cooperation across Electricity and Gas networks, as well as Local Authorities and all other players in the energy sector, will be fundamental to achieving Net Zero.

6. Are there additional opportunities for change and benefits that we have not set out?

Whole system planning should be broadened beyond energy sector and local authorities to include other important institutions that are critical to achieving net zero targets i.e. water, , transport. The Incorporation of these actors into the process will yield further benefits, synergies and efficiencies as process and outputs are inherently linked.

7. We set out a number of risks associated with change. Do you agree with these risks and the potential costs they create? Are there additional risks of change and costs that have not been set out?

Yes, we agree with the risk set out in the consultation. We note that, implementing any of the changes considered also could result in large (unnecessary) additional costs, distractions, loss of momentum and delays to the delivery of Net Zero.

We have also identified the following additional risks that need to be considered:

- Need clear roles and responsibilities and accountability.
- Lack of appropriate incentives to drive the changes.

8. For each model, we have set out the key assumptions which need to be true for the model to offer the right solution. Which of these assumptions do you agree with?

As set out in the response from the ENA. The assumptions that have been provided are high-level and lack detail. Subsequently, it is difficult to judge the accuracy of the assumptions with any level of certainty. There is several areas that need to be clarified and additional assumptions likely added. For example, it is unclear what the assumptions and the impact(s) will be on the regulator for the models. There is the potential for very large changes in regulation, particularly for option 4. It is also unclear how incentives would work if functions were to be split across different entities. We consider more work, potentially with a cross sector engagement and input is required to further develop these models. If this were to happen, we also propose that both a qualitative and quantitative impact assessment of the 'options is undertaken to ensure that the accuracy of the assumptions with a strong level of certainty can be considered.

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9. Out of the framework models we have developed which, if any, offer the most advantages compared to the status quo? If you believe there is another, better model please propose it.

We do not consider that there is enough detail provided in the models for us to select one as having the most advantages over the status quo. These models present potentially major institutional change to the energy system and there are big risks associated with large scale change without properly quantifying and understanding the benefits. We thus strongly advocate for evidence driven decision making when considering these changes.

10. What do you consider to be the biggest implementation challenges we should focus on mitigating?

Cost, time, and complexity are the biggest challenges in implementing any major institutional change, in addition to accommodating conflicting interests and priorities between relevant actors.

11. Taking into account the varying degrees of separation of DSO roles from DNOs under framework model 1, do you consider there are additional measures we should consider implementing, in particular in the short term (e.g. changes in accountability etc)?

No comment.

12. Are there other key changes taking place in the energy sector which we have not identified and should take account of?

There are several key changes taking place in the energy sector which need to be taken into account in these models, these include:

- The Energy Bill recently announced in the Queen's Speech.
- Future Government decisions on hydrogen blending in 2023, hydrogen for heating in 2026 and heat network zoning policy.
- More detail about the interaction with the ESO, and then the FSO, and all associated reforms.
- Changes required to National planning regimes and Net Zero responsibilities placed on local authorities. Many of the planning processes are outside of Energy Networks' and Ofgem control, and hence changes to these systems will need to be factored into the models.
- The role of storage in the energy system.
- Changes to markets and networks tariffs: both the discussions on Locational Marginal Pricing (LMP) and the UoS charging reforms being reviewed by Ofgem as a part of the SCRs¹ (which

¹ <https://www.ofgem.gov.uk/publications/access-and-forward-looking-charges-significant-code-review-consultation-minded-positions>

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could have the effect of providing implicit flexibility to Networks), need to be factored in. These changes will likely influence the size and location of flexibility markets, as well as how Networks are operated.

- BEIS Retail Market Review and Review of Electricity Market Arrangements (REMA).
- There are new and emerging “Non-DSO” services, for example peer-2-peer trading and community energy trading, which could have a significant impact on how the energy market functions.
- The growth of private networks and IDNOs, which are not subject to the same regulatory framework.
- Government will also need to be cognisant of the multiple changes that we believe will be required to governance and institutional arrangements on the journey to Net Zero. These changes will be triggered by different policies and industry trends, and hence we need to have a more agile and iterative approach.
- BEIS energy code reform.
- The wider market issues associated with gas being a part of the future energy system have not been adequately addressed and it is not clear how they will be addressed and incorporated into the framework. This must be considered upfront as a part of the proposed solution and not an afterthought to be bolted on at a different point in time

13. What do you consider to be the most important interactions which should drive our project timelines?

Interaction with the energy networks and the broader energy industry will be critical to provide more detailed models, define roles and responsibilities and assess costs/benefits and ensure the delivery of the best whole systems outcomes. As a part of these interactions, clarity on the timelines, next steps, and the way forward for this work would be appreciated.

If there are any queries or additional information or clarity required for any of the NGN responses, please contact Greg Dodd, Head of Strategic Planning, (gdodd@northerngas.co.uk), who will be able to deal with your query.

Kind Regards



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