

National Grid Gas Transmission Independent User Group: Response to Ofgem's Open Letter on Future Systems and Network Regulation

I write to you as the Chair of the National Grid Gas Transmission Independent User Group, who as Ofgem will know, provide independent challenge and scrutiny to NGGT on the business's performance and the quality of its engagement with the stakeholder groups that use the gas transmission network, now and in the future. Set up in as part of the RIIO-2 business plan development process, we will continue to perform this role into the next transmission price control.

The IUG broadly agree with the findings in Citizens Advice's recent report¹ on Future Network Regulation that "While the current price control framework, known as 'RIIO', is largely positive and should be retained, there are changes needed to make it fit for the future." Below we set out our high-level thoughts on the priorities for the future and the aspects of the RIIO framework that we'd like to see evolve in T3.

- **Whole system** – the framework needs to highlight, enable and reward greater whole system, cross-sectoral collaboration and optimisation to deliver resilient, reliable and safe energy networks that support a thriving economy, communities and environment. This should be reflected in strategic planning, design and performance incentives. There is a need to create a shared vision for the future that goes beyond the future energy scenarios to include wider stakeholder perspectives on the wider societal outcomes required. How we get to this vision may change, but the end goals, in terms of outcomes wanted are likely to remain static.
- **The need for investment** - We agree there is significant uncertainty around the role of hydrogen in the net zero transition and heat decarbonisation. A policy decision is expected in 2026 but its scope remains unclear. Ofgem should not defer investment in hydrogen as even in the most scaled back future hydrogen scenario, investment will still be needed, at the very least for safety reasons. A re-opener may seem like an attractive solution, but the challenge is too important to be deferred in that way. Articulating the known unknowns would be a useful first step in designing appropriate uncertainty mechanisms. Ofgem should be regularly engaging with government (including the devolved administrations) to establish a clearer sense of what needs to be delivered. There will also be implications for asset lives (currently set at 40 years for gas distribution)² and potentially a radically different approach to the recovery of the fixed network costs across a declining customer base should be considered. All of which need discussion.
- **Inter-generational affordability and best value plans** – Recent price controls have benefited from a falling cost of capital which has allowed for significant increases in investment while still delivering falling network costs on customer bills. As borrowing costs increase, investment becomes more expensive which in turn increases the tension between keeping bills as low as possible and the need for investment. While the transmission element of the bill is relatively small, affordability is still an important consideration. Focus should not simply be on the lowest cost business plans, but best value plans, taking into consideration wider social, environmental, and economic impacts and intergenerational considerations.

¹ <https://www.citizensadvice.org.uk/about-us/our-work/policy/policy-research-topics/energy-policy-research-and-consultation-responses/energy-policy-research/future-network-regulation-delivering-a-regulatory-framework-fit-for-the-future/>

² The Grid Edge Policy paper on asset lives in ED2 (submitted in response to the Call for Input on the Business Plans) highlights the complexities around the simple sounding idea of changing asset lives and advocates a different model based on the approach in water

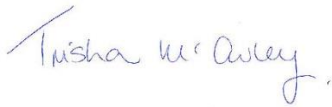
- **Longer-term plans and adaptive planning** - One of the limitations of RIIO is the five-year time periods. However, separately, the networks have requirements to produce ten-year Network Development Plans. Making the linkage between the price control and the longer-term plans (as Ofwat are seeking to do in PR24) could facilitate a longer-term perspective supported by adaptive planning.
- **Stronger focus on environmental outcomes and climate impacts** – this includes not just delivering net zero but supporting a thriving environment more generally with networks that operate within planetary boundaries. The Climate Change Commission has regularly highlighted the lack of climate resilience in the energy networks with the potential for damaging cascade effects across other forms of infrastructure. This issue had relatively little focus in RIIO-2 and needs more profile. Ofgem risks being significantly out of step with changing attitudes and expectations, and this isn't adequately reflected in the open letter.
- **Strengthening stakeholder voices and tackling the information asymmetry** – not unsurprisingly as an IUG, we think there have been significant benefits from Ofgem's enhanced engagement process and would welcome greater discussion on how this might evolve and be further embedded across the sector. The IUGs and CEGs contain considerable breadth of expertise that can help to address the information asymmetry when properly resourced. Early clarity on the role of the user groups would be welcome and more generally around how stakeholder views will be reflected in decision-making. This includes understanding how views will be weighted and the values and rationale behind trade-offs made. In practice, the information asymmetry challenge is exacerbated by the high turnover of employees at Ofgem and declining levels of regulatory and network price control expertise within the regulator.
- **Clarifying different networks' roles on social issues** - there is a lack of clarity on the roles and responsibilities of different actors in the energy system on social issues including energy efficiency, affordability and supporting consumers in vulnerable situations. IUG members have different views for example on the boundary of the transmission company's responsibility and role in this area.
- **Incentive framework** – The current incentive framework works reasonably well but Ofgem could consider how it can strengthen the effectiveness of reputational incentives e.g., by ensuring targets are comparable and performance more proactively publicised. For example, the Environment Agency's Environmental Performance Assessment EPA (four-star ratings) has started to attract media coverage and now genuinely helps shine a spotlight on good and bad performance³. Though current water company environmental performance arguably also highlights the limits of reputational regulation.
- **Simplify the framework** – we agree that the process is resource intensive and support the need to simplify the regulatory regime. It is important however that this doesn't come at the expense of consumer outcomes or a lack of flexibility in terms of networks' ability to set performance targets that reflect and respond to community views.
- **Innovation** - Ofgem's approach to innovation incentives is recognised by some stakeholders as best practice and as a global first, where an entire sector is incentivised to innovate where the outcomes of that activity can then be measured. However, innovation is a journey and the different price controls enable the regulator to iterate and further develop the approach. The next price control framework needs to continue to build upon the strong foundations created by the NIA, enhancing

³ <https://www.bbc.co.uk/news/uk-england-devon-62165601> and <https://www.gov.uk/government/publications/water-and-sewerage-companies-in-england-environmental-performance-report-2020/water-and-sewerage-companies-in-england-environmental-performance-assessment-epa-metric-guide-for-2020>

measurement and value and creating an environment of collaboration in innovation. For innovation to flourish at such a crucial time in our energy sectors history, there is a need to maintain continuity, consistency and flexibility. A continued focus on ensuring that innovation funded by customer money is shared and embedded into business as usual would also be welcome.

We welcome Ofgem issuing this open letter on the future of energy network regulation and for the opportunity to comment at an early stage. We would encourage Ofgem to continue in this timely manner and provide the earliest decision on the methodology. Our experience in RIIO-2 was that timeframes were significantly compressed with the final Sector Specific Methodology for gas published only shortly before the first draft plans were due in.

Yours Sincerely

A handwritten signature in blue ink that reads "Trisha McAuley". The signature is written in a cursive, flowing style.

Trisha McAuley
Chair
National Grid Gas Transmission Independent User Group