

RIO-3 Sector Specific Consultation Response

Environmental Outcomes and Incentives:

- Environmental Action Plans
- Climate Resilience
- Nature Impact



RIIO-3 Consultation Response

Ofgem, as the energy regulator in the UK, sets price controls on the companies that run the gas and electricity networks in Great Britain to ensure that current and future consumers get the network services they require at a fair price. We do so through the RIIO model, where we set network company Revenues using Incentives to deliver Innovation and Outputs.

The current RIIO-2 price controls for the electricity and gas transmission and gas distribution sectors are due to finish in March 2026. The RIIO-3 price controls for these sectors will then start on 1 April 2026. As part of preparing for this new process, Ofgem is running a consultation process to determine whether the current minded-to position is fit for purpose to regulate these networks from 2026 to 2031.

The below is a snapshot of our consultation response, submitted to Ofgem by Guidehouse, focusing on the environmental outcomes and incentives, with a specific focus on environmental action planning, climate resilience, and nature impact.

As part of the Sector Specific Methodology Consultation (SSMC), there are several questions across environmental, climate, and nature related topics where we at Guidehouse would like to provide our input. As part of the Overview Questions covering Outputs and Incentives, Environmental Action Plans (EAPs), Annual Environmental Reports (AERs), and Climate Resilience Strategies are discussed between questions OVQ16 and OVQ25. Our response focuses on these areas.

At Guidehouse, we sit at the crossroads of energy infrastructure and sustainability strategy. We support clients with climate and nature risk assessments, resilience strategies and disclosure support across TCFD, TNFD and CSRD. Through decades of experience with sustainability and energy network regulatory requirements, we identify, develop, and refine leading decarbonisation strategies and environmental action plans for network operators. We are members of the TNFD forum and SBTN network and support companies who wish to be early adopters in assessing and disclosing their nature risk and opportunities.

OVQ19. Are there any other suggestions you would like to make regarding reporting standards?

On the matter of Business Carbon Footprint (BCF), there is a need for standardisation and comparability on BCF categories that Ofgem requires businesses to report on vs requirements set by Greenhouse Gas (GHG) Protocol. Taking the example of methane emissions within Gas Transmission, Ofgem currently only requires the inclusion of compressor venting and terminal & compressor fugitives in Scope 1 reporting. But as per GHG protocol, methane emission from Above Ground Installations (AGIs), Pipelines, Operating Assets etc. (which are covered as transmission losses currently) also need to be reported in Scope 1 emissions. The lack of alignment between Ofgem's BCF requirements and GHG protocol can cause discrepancies when developing target boundaries to set net zero targets.

We also recognise the need for including Scope 3 reporting requirements for all transmission and distribution networks. Building on RIIO-ED2 Environmental Reporting Guidance which mandates Scope 3 reporting for electricity Distribution Network Operators (DNOs), there is also an urgency to mandate the inclusion of setting Scope 3 abatement targets for all networks to ensure sufficient progress is made in reducing value chain emissions by 2030.

These discrepancies can, at a high level, be seen across the industry with distinct variation in the scope, granularity, and distinction in what a "net zero" target consists of. While there is work underway by the Science Based Targets initiative to define the process for science-based targets for Oil & Gas companies, standardisation by Ofgem can improve the readability and comparability of business plans by minimising excluded sections and clarifying definitions of key portions of BCF reporting.

OVQ23. Do you have any views on our proposed long-term approach to embedding climate resilience, including the principles for embedding climate resilience?

Considering the increasing need to plan for climate adaptation, the long-term approach to embed climate resilience in RIIO-3 planning is a welcome proposal. Network assets will need to be assessed for resilience against high-impact events, with increasing clarity on the costs and benefits of necessary adaptive interventions.

The need for granular, reliable climate data at an asset level (3 – 90m resolution as opposed to 1 – 25kms) is evident and network operators will need to invest in obtaining such data, to plan for an informed resilience strategy. To ensure security of supply for customers, it is imperative that network operators understand the physical climate risk related failure thresholds within network assets and identify critical assets that compromise reliability and resilience.

From an environmental disclosure perspective, a climate resilience plan could also tie in with the expected UK Sustainable Disclosure Standards (UK SDS) which uses the IFRS (International Financial Reporting Standards) sustainability standards as a baseline. The IFRS S2 requires entities to disclose information about their climate-related risks and opportunities. A detailed understanding of these risks and opportunities will be imperative for network operators to create a climate resilience strategy, and for Ofgem and the climate resilience working group to establish whether these strategies are credible and beneficial for consumers.

OVQ25. Do you agree with our suggested approach for embedding climate resilience into RIIO3, namely: introducing resilience strategies; developing forward-looking resilience metrics; and introducing climate resilience working groups?

For a comprehensive outlook on environmental resilience within the networks, it is also important to consider a broader nature resilience in future planning. Physical and systemic

risks stemming from nature decline can include a wider spectrum of events that impact the network, such as loss of climate regulating services (e.g., protection from landslides) due to loss of vegetation and upstream supply chain disruptions due to ecosystem collapses.

The Kunming-Montreal Global Biodiversity Framework (GBF), ratified in December 2022, contributed to the launch of key guidance and frameworks around nature, such as the Taskforce on Nature-related Financial Disclosures (TNFD) and Science Based Targets for Nature (SBTN). One of the GBF targets require businesses to comprehensively evaluate and disclose their biodiversity impacts and dependencies, and associated risks from their operations and value chains.

Nature related assessments have therefore moved beyond monitoring the biodiversity net gain targets which are currently included in network EAPs. Considering the increased availability of tools and the likelihood of impending legislation around nature risk, we believe Ofgem should consider including nature impact/resilience as an added requirement for network operators.

An integrated approach between climate and nature could result in an expanded 'environmental resilience' strategy, following a similar governance structure of a working group, and the development of forward-looking metrics to enable comparison across time periods and between operators. Such an integration will help network operators arrive at a holistic understanding of environmental risks and lead to resilience strategies that cover larger systems, preventing unintended negative consequences.

Regarding the regulatory treatment required to facilitate this work, we feel that a model built on an uncertainty mechanism, a regulatory sandbox, or a Use-It-Or-Lose-It (UIOLI) allowance with a low threshold for activation could lead to the required funding environment for networks to trial and measure innovative nature-positive activities, leading to a more environmentally resilient network. Without the required thinking in place for metrics, baselines, and targets, a formal Output Delivery Incentive (ODI) at this stage may lead to limited ambition or more subjective targets. However, an approach similar to the Vulnerability and Carbon Monoxide Allowance (VCMA) fund for GD2 which has delivered £millions in social value through light touch project applications, industry collaboration events, and high-level oversight from Ofgem, could deliver the flexibility required to respond quickly to a fast-moving situation.

We look forward to developing this concept further with Ofgem and the Networks while the RIIO-3 Sector Specific Methodology Decision (SSMD) and draft Business Plans are being prepared and would be happy to discuss any point of our response when and where appropriate.

Contact About Guidehouse

Nye Gordon, Director
ESI EP Advisory EME
ngordon@guidehouse.com

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