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19 January 2024

Our ref: RIIO-GD3 SSMC

RIIO-3 Team
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By email only to RIIO3@ofgem.gov.uk

Dear RIIO-3 Team

BUUK Infrastructure welcomes the opportunity to respond to Ofgem's consultation on the sector specific methodology for RIIO-3. BUUK is the leading provider of independent utility networks in GB and operates across a range of utilities including electricity, gas, heat, water and telecoms. This cross-utility experience has also provided us with experience of a range of regulators and pricing mechanisms.

BUUK owns and operates three licenced IGT business through its subsidiaries GTC Pipelines Limited (GPL), Independent Pipelines Limited (IPL) and Quadrant Pipelines Limited (QPL). These licensees operate under a relative price control framework which limits charges that they can make to energy suppliers to being equivalent to that of the upstream, incumbent network operator.

Ofgem's sector specific methodology sets out, in a number of areas, the case and need for change in the way that the energy networks will need to be funded throughout the late 2020s and into the 2030s. As an independent network operator these changes are likely to have an impact on BUUK by proxy through the application of the relative price control framework. We have provided, therefore, answers to Ofgem's questions in policy areas which will directly or indirectly impact BUUK in the appendix to this response. However, there are two areas which should be highlighted:

- Intergenerational fairness should apply equally to customers who are connected to IGT networks, and where solutions are put in place to reprofile the depreciation of GDN RAV balances to accelerate capital recovery in the near future, the same solutions should be available to IGTs to ensure that IGTs' customers who remain connected to the gas network do not face a disproportionately higher burden of costs. Such a solution would also address the risk of asset stranding on IGT networks where the ability to recover sunk investment is dependent wholly on an IGT's ability

to track GDN charges and the extent to which those GDN charges recover costs for capital expenditure.

- We anticipate significant volumes, and cost, of disconnection to the gas networks over the next price control if government targets on heat pumps are met. Disconnection costs which are borne by networks will need to be recovered from network users in a fair, and proportionate way, maintaining the balance between existing and future consumers. We anticipate that this will impact IGT networks and believe that the current framework will need to be modified to ensure that IGTs can recover the costs which it reasonably incurs in ensuring safe operation of their networks.
- Repurposing and decommissioning of the gas networks is likely to have an impact on IGTs in the same way that it will impact on GDNs. We recognise that Ofgem does not envisage significant cost in this area during the proposed timespan of RIIO-GD3 but it remains important that IGTs can be funded through the relative price control framework where GDNs, and therefore IGTs, incur costs related to these activities.
- It is important that outcomes from RIIO-GD3 do not have unintended consequences on the proposals for a Hydrogen Transport Business Model which could inadvertently reduce competition for the delivery of networks and risk cross-subsidy or inefficiency of delivery. IGTs have a proven track record for delivering for customers and the GDN price control should not have the outcome of foreclosing this market by providing revenue funding or any activities which could be better delivered in a competitive environment.

Overall, these areas highlight the potential need to ensure that the current relative price control framework remains fit for purpose given that we are currently awaiting government policy decisions which will impact the future use of the gas networks. We would welcome engagement with Ofgem, either bilaterally or through the Independent Networks Association (of which BUUK is a member) to ensure that the IGT framework continues to deliver appropriate customer outcomes whilst enabling to IGTs to access the funding required to fulfil the obligations imposed on it by its licence.

If you have questions in relation to the points made in the letter or the appendix, we would welcome continued engagement to ensure the best outcomes for existing and future customers.

Thomas Cadge
Head of Regulatory External Affairs

Appendix 1 – Responses to questions

OVQ1 - Do you agree with our proposal for how RIIO-3 should interact with the Hydrogen Transport Business Model?

We agree with Ofgem's proposal that costs associated with the development of new Hydrogen infrastructure should be out of scope of the RIIO funding mechanisms. We have consistently brought innovation and customer focussed solutions to gas customers and we believe that there is an opportunity for the independent sector to continue to bring this skill and experience to Hydrogen gas transportation. Providing funding for development of hydrogen projects in the RIIO-3 framework would provide an undue and unnecessary cross-subsidy for GDNs seeking to compete for the provision of new hydrogen assets and could have the unintended consequence of foreclosing the market to competition.

Where existing assets are repurposed and transferred only the costs which relate to the work which would be incurred irrespective of who adopted the assets after they are repurposed should be included within the scope of RIIO.

OVQ2 - Are there any additional activities relating to the development of hydrogen transport infrastructure, or repurposing of natural gas assets, that you think should be funded through RIIO-3, and if so, why do you think this is justified?

Notwithstanding our answer to the above question, we do still see a role for existing gas networks to play in the future of Hydrogen and we think it is, therefore, in the wider consumer interest for innovation related to Hydrogen transportation to be considered within the scope of RIIO. This may take the form of innovation trials, or testing, and could be recovered through the existing elements of the RIIO framework which support such innovation but whilst government policy is still open to a future where hydrogen plays a role in home heating, there must be adequate funding to ensure that the case for that role is properly supported.

OVQ3 – Do you agree with the proposal that network costs relating to hydrogen blending at both distribution and transmission level should be included in the RIIO-3 net zero related UMs? If so, which mechanism do you think is the most appropriate for these costs.

We agree that some network costs associated with hydrogen blending should be included in uncertainty mechanisms. However, given that the government has signalled its support for the use of hydrogen blending in gas networks, we believe that there is likely to be a level of certainty on some network costs which are required to support this transition to a blended gas network. Where those costs are certain, known and required to support that government policy then we see no reason why these costs should not be included in core business plan allowances. This could bring certainty to investors in the gas networks that they are being signalled to support this government policy and invest in the necessary elements of the network to support blending.

OVQ4 – What are your view on the proposal of using the GD specific Heat Policy re-opener, the RIIO-3 net zero related UMs, or a mixture of both to fund network costs incurred as a result of the government's 2026 decision on hydrogen for heating (where RIIO is deemed to be the most appropriate funding mechanism for these costs).

We agree that it is appropriate to use a mixture of both at this stage as there is not yet clarity on the government policy.

OVQ4 – What are your views o our proposal to not enable funding for further evidence relating to repurposing the existing network for hydrogen heating ahead of the government decision on hydrogen heating in 2026?

We disagree with Ofgem's view not to allow further funding for support the government's decision. Where further information is required, within the RIIO-3 time period, to support the government's decision or to gather information and evidence on the role of using hydrogen for heating then it should fall within RIIO to fund these costs. Given the magnitude of this decision it is important that it is well-informed using the most recent data and gas networks are an appropriate mechanism for information gathering. It is necessary to fund these costs within RIIO given that they will have an impact on all gas consumers.

OVQ6. Should RIIO-3 help to manage future gas network decommissioning costs? If so, do you have views on what these costs could be and what mechanisms should be used, including for anticipatory funding?

We believe that RIIO-3 should help to manage future gas network decommissioning costs. We agree with Ofgem's broad assessment that RIIO-3 is unlikely to see significant parts of the gas network decommissioned, but it is important to note that individual disconnections of customers, where they opt for alternative heating, are likely to rise significantly throughout the period and must be addressed directly in the price control. If the government meets (or meets a percentage of) its target of 600,000 heat pumps, then there will be a significant cost burden which is likely to fall to network operators to decommission the service pipe. There is a risk that these costs will be borne by future customers, compounding the issue of intergenerational fairness.

This is an issue which is pertinent to IGT businesses too and which any solution that covers GDN decommissioning needs to be applicable to IGT networks. Under the current relative price control arrangements there are limitations on the way that GDN revenues can be passed through to IGTs and we believe that this issue is an area where the framework which price controls IGTs may need to adapt. We would welcome further engagement with Ofgem on this point to ensure that IGTs and IGT customers are considered within the discussion for anticipatory investment of decommissioning.

We believe that the risk to future customers and the risk of intergenerational unfairness means that it is relevant for anticipatory funding to be considered within the RIIO-3 price control. It is currently unclear the extent to which decommissioning will be required on the gas networks and the form or scope which it will take but we recognise that there is almost certainly going to be elements of the network which need to be decommissioned. By spreading the decommissioning costs over the broadest customer base and a longer period of time, Ofgem and the GDNs will not only be reducing the cost per customer in any given year but will also be ensuring that all customers who have benefitted from the use of the gas network are liable to pay their fair share of decommissioning any parts of the network, irrespective of whether or when the parts to which they connect are decommissioned.

FQ21. GD & GT: assuming re-openers are available and there is no adjustment to the allowed WACC, how should regulatory depreciation be used to address the uncertainty around the future path for gas and perceived asset stranding risk?

We believe that reprofiling depreciation to accelerate depreciation from the start of RIIO-3 with the aim of smoothing our depreciation costs on a £/customer basis to the government's net-zero commitment in 2050 is sensible and fair approach. We believe that this provides gas network investors with an element of certainty of cost recovery. Ofgem have identified that this reduces the need for investors to be compensated for risk, or perception of risk, with an increased cost of capital and it therefore reduces cost to customers.

It is also possible that reprofiling depreciation reduces the potential for a distortive cost signal to be sent to customers which may increase the potential for a feedback loop as the depreciation costs are being recovered from a reducing balance of customers. This would also ensure that the transition to net-zero, whether it is through electrification, hydrogen or other means, can be managed in a proportionate way.

As with our answer to the question on the potential costs for decommissioning the gas network, we believe that the solution to this question needs to flow through to IGT networks where there is the real risk that assets which have previously been funded through responsible investments are not unrecovered. It is likely that the solution to GDN asset depreciation could be fit for purpose for IGT networks, but it is also imperative to ensure that the solution feeds through to IGT revenues to the extent to which it is necessary. Currently, the RPC framework limits this ability through the application of the floor and ceiling mechanism. We are keen to work with Ofgem to ensure that the price control mechanism utilised for IGTs, is updated and remains fit for purpose for a changing, and dynamic energy network.

FQ22. GD & GT: what long-term path should regulatory depreciation aim to follow between 2026 and the assumed de-energisation point to promote fairness for current and future consumers? What unit metrics should this be based on? Is this resilient to the various scenarios under FES 2023?

We believe that the regulatory depreciation path should be based on aggregate peak capacity of the gas network. Customers generally pay network charges in proportion to their peak daily capacity, and we think it is reasonable, therefore, to utilise this to model an accelerated path for depreciation as it would provide a more cost reflective proxy for depreciation that units flowing. We think that this is resilient to scenarios under the FES because it is closely aligned how networks are planned and funded. Currently, there is no consideration for how transitional technologies such as hybrid boilers might impact each FES and so we believe that tracking the peak capacity of the network better reflects how customers should fund the depreciation.

FQ23. GD & GT: assuming there is a relevant gas reopener for government policy, is there a need to reopen regulatory depreciation policy intra-period?

There may be the need to reopen regulatory depreciation policy intra-period. We do not have particularly strong views on how this could work but would prize a solution which ensures that costs associated with risk, which can be avoided by the right approach, are unnecessarily passed on to consumers.

FQ24. GD & GT: what considerations are raised by asset repurposing and how might these affect the decisions to be made on regulatory depreciation policy? What guidance is sought for the SSMD so that licensees have sufficient clarity for their business plans?

We recognise that asset repurposing interacts with the depreciation of assets, however, we don’t see that this is an issue which needs to be addressed in the RIIO-3 methodology. The is not sufficient clarity on what repurposing might need to be undertaken closer to 2050 and we think that between price control periods, or within price control periods, there are sufficient mechanisms to be able to deal with the issue of repurposing and to realign the profile of regulatory depreciation that it does not need to be addressed in the RIIO-3 SSMD.