

Summary of Ofgem's RIIO-GD2 Decarbonisation stakeholder group – meeting 1

From: Ofgem

Date: 29th August 2018

Location: Ofgem (Canary Wharf, London)

Time: 10:00-16:00

Attendees: Ofgem, the GDNs, the Energy Networks Association, Committee on Climate Change, Scottish Government, Citizens Advice, Welsh Government and BEIS.

1. Introduction (Pete Wightman, Head of Gas Distribution)

- 1.1. Ofgem presented an overview of the purpose of the meetings and RIIO-2, including initial thinking on outputs and incentives in RIIO-2.
- 1.2. It was suggested that meetings should be arranged on a monthly basis leading up to December, with the initial focus of the groups at this stage to be on outputs and incentives. The focus of the meetings is likely to evolve as they progress. All slides for each topic are on our website.

2. How should the GD2 price control support the energy system transition? What are the 'no regrets' options on green gas, and what is the price control's role? (Cadent)

- 2.1. There was discussion around the ways to assess decarbonisation options across an integrated energy system with some discussion of:
 - Whether there should be positive discrimination towards green gas.
 - Transportation being a potential key driver for investment over RIIO2.
 - How gas entry and exit costs are apportioned.
 - Potentially producing a commercial side to gas storage value in the network.
 - How whole system costs can be considered through the RIIO process.
 - Whether the counterfactual used for cost benefit analysis should be against the status quo or against other decarbonisation options such as the electrification of heat.
- 2.2. For the RIIO-GD2 regulatory framework to support the energy system transition:
 - The specific RIIO2 Innovation scheme was seen as important (including whether there should be one cross sector pot or a specific pot for heat projects) to fill evidence gaps required for policy decisions on the future of heat.
 - More flexibility may be required in order to adapt to changes that could occur during the price control period.
 - No/low regrets investments to prepare the gas network for a potential hydrogen conversion should be included in business plans.
- 2.3. The role gas networks companies can play in wider energy policy objectives, relative to what they do now, was discussed. Several stakeholders highlighted that any substantial change in approach for RIIO2 should be driven by Government. It was seen as

important to get clarity on the roles of Ofgem and BEIS and be realistic on what can be achieved in RII02 timeframes to facilitate any change in Government policy.

3. Should we be extending the gas grid given uncertainty over the future of heat? (Southern Gas Networks)

- 3.1. There was discussion about the potential scenarios regarding the future of heat e.g. electrification, heat pumps, (more/less) connections to gas, declining use of coal and nuclear sources, and how RII02 should prepare for these changes. Some stakeholders also raised the point of considering the type of uncertainty, for example uncertainty in demand and uncertainty in future government policy. There was broad recognition that legal requirements may be a barrier, e.g. Competition / Gas Act, to changes in the approach to gas network connections. As such, Government policy would be key to drive change here and should be considered against its wider approach to heat (e.g. electrification of heat).
- 3.2. In the context of the existing RII0-GD1 Fuel Poor Network Extension Scheme, there was some discussion around the role GDNs should, and could play, working with other stakeholders (such as local authorities) to consider alternative approaches to connections – e.g. alternative heating.
- 3.3. There was discussion about the current 'Economic Test' for connections and whether this is driving the right behaviour in encouraging (or not) connections to the gas grid. Key questions points included:
 - The balance of costs shared across all network users as opposed to the connecting customer.
 - What's considered a benefit and cost in the economic test.
 - The role of Government – to the extent changes may be needed to Gas Act to facilitate any change in gas connections policy.

The next meeting will focus in more detail on the role of the economic test and connections.

4. In the absence of government policy direction, what should GD2 do for the future of heat? (Northern Gas Networks)

- 4.1. It was acknowledged by the group that there is unlikely to be any firm policy decisions on the decarbonisation of heat by the Government before the start of RII0-GD2.
- 4.2. Innovation, and how this will be funded under RII0-GD2, was a key area of discussion including:
 - Use of the RII02 innovation scheme to support building a strong knowledge base on heat for RII03 – for this it will be vital to understand what questions need answering by policy makers.
 - The potential need for clarification around the definition of 'innovation' and the type of innovations that will be eligible for funding.
 - The potential importance of avoiding spending that is subsequently not needed when Government policy direction is clear.

- 4.3. It was seen as important by some stakeholders to:
- Understand what the RIIO2 innovation mechanism will look like (how it will work and how much will be available).
 - Understand how heat related projects will be treated under the RIIO2 regulatory framework (e.g. specific heat investments or accelerating parts of the repex programme).
 - To avoid 'regrettable spending' surrounding investments into higher risk projects, however, there is opportunity to make marginal changes that are low impact and 'low regret'.

5. What more should be done to ensure the companies decarbonise their operations, including on shrinkage? (Wales and West Utilities)

- 5.1. It was noted that this area is more within the GDNs control than the earlier discussions. It was also noted that there are reputational benefits from decarbonising operations due to the strong support from stakeholders, which acts as an incentive. Some stakeholders thought that the wider reputational incentives are a stronger incentive to decarbonise operations than some of the RIIO-GD1 incentives, although it was noted that challenging targets were set at the start of the price control period.
- 5.2. The group discussed the potential addition of a carbon value to the cost benefit analysis for investment decisions which could drive what the GDNs put forward through their business plans. The group also discussed the GDNs potential role in the implementation of gas vehicles and noted that clean air directives could increase the number of gas vehicles in RIIO-2. The GDNs thought that shrinkage incentive should continue in RIIO-GD2 and that there are still ways to improve shrinkage. For other areas, the idea of bespoke company specific outputs was discussed, which could feature as part of business plans.