

Oil & Gas UK  
2<sup>nd</sup> Floor  
The Exchange 2  
62 Market Street  
Aberdeen AB11 5PJ

Telephone +44 (0)1224 577 250  
Fax +44 (0) 1224 577 251  
Email [info@oilandgasuk.co.uk](mailto:info@oilandgasuk.co.uk)

[www.oilandgasuk.co.uk](http://www.oilandgasuk.co.uk)

To be sent electronically to: [RIIO2@ofgem.gov.uk](mailto:RIIO2@ofgem.gov.uk)  
15 March 2019

## **Oil & Gas UK response to the RIIO2 Ofgem Sector Specific Methodology Consultation**

Oil & Gas UK is the leading representative body for the UK offshore oil and gas industry with over 350 members. Our aim is to strengthen the long-term health of the offshore oil and gas industry in the United Kingdom by working closely with companies across the sector, governments and all other stakeholders.

The oil and gas sector is a UK industrial success story, supporting some 330,000 jobs (direct, indirect and induced) across the UK. The industry is a centre of excellence and expertise for offshore technologies and subsea engineering and has supply chain exports worth £12billion per annum to the UK economy. The oil and gas industry not only makes a vital contribution to the economy and the UK's security of energy supply, but it also possesses significant opportunity to help achieve the UK's climate change targets.

We, on behalf of our members, appreciate the opportunity to feed into this latest phase of developing the framework for the RIIO-2 price controls. This response largely concentrates on issues relating to the gas transmission network which has the most direct impact on Oil and Gas UK members (Annex A). Where appropriate, general comments are also provided on the cross sectoral methodology (Annex B).

As we noted in our response to the March 2018 consultation (Annex C) the overarching output categories relating to consumers and network users need to be interpreted in a way that takes account of wider energy policy objectives. This includes the legal requirement on operators and the Oil and Gas Authority (OGA) to maximise economic recovery of production from the UK Continental Shelf. This is, in any case, consistent with the objectives of the proposed RIIO2 framework and its focus on consumers and future energy systems.

In particular, maintaining a diverse range of supplies of natural gas, including indigenous resources, and a liquid wholesale market is strongly in the consumer interest. These contribute to efficient market conditions and promote a more competitive and effective retail market. Likewise, the indigenous UK gas sector is an integral part of the transition to a future low carbon energy system and provides a platform for low carbon investment such as carbon capture, usage and storage (CCUS) and decarbonised gas in the form of hydrogen and other alternatives.

These points are particularly relevant to the discussion around the capability and reliability of the gas transmission network over the RIIO2 period. The latest estimates from the OGA, which have been updated to take account of recent gas discoveries, suggest production of natural gas will still be around 0.48mboed by 2024.<sup>1</sup> This could increase further if the objectives of Vision 2035 are realised and, in any case, still represents a significant proportion of UK demand. Although there may be some reduction in demand over the period, the overall situation in the gas sector will not radically change over the RIIO2 period. Ongoing investment in both network capability and asset health therefore remains essential and continues to be in the interests of consumers.

We trust you will find our response helpful. Should you require any further information or have any queries on the above points, please don't hesitate to contact me at [wwebster@oilandgasuk.co.uk](mailto:wwebster@oilandgasuk.co.uk). We will continue to contribute through the RIIO2 process both through the Stakeholder Panel and other working groups.

Yours faithfully,



**William Webster**  
Energy Policy Manager

---

<sup>1</sup> [https://www.ogauthority.co.uk/media/5379/oga\\_projections-of-uk-oil-and-gas-production-and-expenditure.pdf](https://www.ogauthority.co.uk/media/5379/oga_projections-of-uk-oil-and-gas-production-and-expenditure.pdf)

## ANNEX A: RESPONSE TO QUESTIONS ON GAS TRANSMISSION SECTOR SPECIFIC METHODOLOGY

### 2. Context

GTQ1. Do you have any feedback on our proposals for simplifying the RIIO-2 gas transmission price control package, or suggestions for further simplification?

GTQ2. Do you have any views on the extent to which the potential outputs discussed in this document:

- a) achieve the appropriate balance and focus on the areas that are of value to consumers and should be included as part of a RIIO-GT2 outputs package;
- b) align with our overarching outputs framework as described in the Core Document;
- c) we also welcome views on whether there are any alternative outputs and/ or mechanisms not identified here which we should be considering

- The RIIO framework could be improved by being made simpler and the move from six to three overarching output categories reflects this. However, even with the proposed changes the regime remains very complex and difficult to explain in terms of clear benefits to consumers.
- Some of the “underlying elements” are not well developed. The concept of “whole energy system” is unclear and requires further consideration.
- Some elements of the framework appear to duplicate other government policies e.g. carbon reporting and environmental incentives and these could be scaled back.
- The discussion of system operation and capability could be expanded and, in particular, the need to maintain capability to deal with more variable combinations of demand and supply which is an important challenge for RIIO2 period.
- In terms of specific output incentives: the new concept of Price Control Deliverables (PCDs) may be helpful to develop further confidence in the RIIO approach. However, the governance of this is not particularly clear in terms of how delivery will be assessed.
- Further reduction in the number of Output Delivery Incentives (ODIs) would be desirable. This aspect of the framework remains overcomplicated.

### 3. Meet needs of consumers

GTQ3. What are your views on the overall outputs package considered for this output category?

GTQ4. For each potential output considered (where relevant):

- a) Is it of benefit to consumers, and why?
- b) How, and at what level should we set targets? (eg should these be relative/absolute).
- c) What are your views on the design of the incentive? (eg reward/penalty/size of allowance).

GTQ5. What other outputs should we be considering, if any?

GTQ6. What are your views on the RIIO-1 outputs that we propose to remove?

- It is important in designing the framework to have in mind that the gas transmission system does not have many direct interfaces with end consumers or represent a large proportion of their bills. Outputs should be focused on delivering the necessary services to network users so they can respond to the market and serve consumers’ needs.
- Improved outcomes the gas transmission system valued by network users will indirectly be passed on to consumers through more effective competition and therefore better prices and services. The comments below on individual aspects of the framework are made with this process in mind.

**Table 1 Summary Comments on Consumer Related Outputs**

Output	O&G UK Comment
Maintenance: Use of Days and Changes Schemes	Retain incentive and support moving to penalty only.
Connections	Retain as a licence requirement in the UNC Code
Entry and Exit Congestion & Constraint Management	Retain symmetric incentive as important to the question of maintaining capability, review caps and floors.
Residual balancing	Retain incentive as supports functioning of market.
Emergency response and Enquiry	Retain as licence condition.
SEI	Could be removed or absorbed into the Business Plan Incentive
SSO	Could be removed
Demand forecast incentive	Retain but review level of incentive

## Stakeholder Engagement Incentive\Business Plan Incentive

GTQ7. We welcome views from stakeholders on the above options.

GTQ8. Do you think it would be possible to establish clear and appropriate KPIs and deliverables in this area?

- Incentives and structures to improve NGC stakeholder engagement should be retained and improved.
- The incentive on Stakeholder engagement (SEI) could be embedded into new framework for NGC Business Plan – i.e. Option 1.

## Satisfaction Surveys

GTQ9. We welcome views from stakeholders on the above options.

- The stakeholder satisfaction objective (SSO) could be removed. The mechanism is somewhat arbitrary and subjective.

## Quality of demand forecasts

GTQ10. Does NGGT's forecasts of demand provide a service that is valued by consumers and network users? Please explain why.

GTQ11. Should gas consumers pay for NGGT to produce accurate demand forecasts? What is the value for consumers from increased accuracy?

- These forecasts are important for shippers and suppliers to manage risk. Better forecasting supports the functioning of the market which benefits all parties including end users. However, the current band £+/- 10m p.a. is not proportionate and could be reviewed.

## 4. Environmentally sustainable network

GTQ12. What are your views on the overall outputs package considered for this output category?

a. For each potential output considered (where relevant):

b. Is it of benefit to consumers, and why?

c. How, and at what level should we set targets? (eg should these be relative/absolute).

d. What are your views on the design of the incentive? (eg reward/penalty/size of allowance).

GTQ13. Where we set out options, what are your views on them and please explain whether there are further options we should consider.

GTQ14. What other outputs should we be considering, if any?

GTQ15. What are your views on the RIIO-1 outputs that we propose to remove?

GTQ16. We welcome views on whether further regulatory mechanisms are needed to drive NGGT to be more proactive in reducing its impact on the environment and contributing to the transition to the low carbon energy system.

- Overall the extent of outputs set out in this category could be scaled back rather than expanded. It is more the job of wider government policy to achieve environmental objectives and there are numerous incentives and reporting requirements that already exist: e.g. EU ETS, SECR and other CSR reporting requirements.

Output	OGUK comment
Compressor emissions	Ability to run compression is a key part of capability of the system as well contributing to environmental sustainability. The combination of using PCDs plus retaining a similar uncertainty mechanism as in RIIO1 is proportionate. Option 2, which retains flexibility, is preferable although the governance process for assessing delivery and innovation needs to be further developed.
Methane venting	It is not clear that NGC have sufficient control over the need for venting to justify an ODI. This could be better dealt with through a reporting mechanism.
BCF reporting	This aspect of the regime could be reviewed as it is covered by other government requirements i.e. Simplified Energy and Carbon Reporting and wider Corporate Social Responsibility activities and there are potential overlaps.
NTS Shrinkage (GTQ17)	Although the incentive should be retained, there is a case for a review of this incentive especially as it has been outperformed easily in the past. On balance it is sensible to include fuel use as part of totex.

## Low carbon energy systems

Low carbon energy systems and decarbonisation of heat

GTQ18. Do you have any views on how NGGT's can make a contribution to the transition to a low carbon energy system and support the decarbonisation of heat?

Opportunity to propose bespoke outputs

GTQ19. Do you think we should consider proposals from NGGT for additional outputs and incentives to support our environmental objectives

- NGC will clearly be able to make a contribution to the decarbonisation of heat. Initially this could be through accommodating changes to GSMR to allow more decarbonised gas, including hydrogen.
- Deliverables should not be set until they can be better defined. These are more likely to be specific outputs that could end up as PCDs. But it is important that these have stakeholder buy in from the Business Plan process. This includes any projects under the heading "whole system solutions" (see Annex).

## 5. Safe and resilient network

GTQ20. What are your views on the overall outputs package considered for this output category?

GTQ21. For each potential output considered (where relevant):

- Is it of benefit to consumers, and why?
- How, and at what level should we set targets? (eg should these be relative/absolute).
- What are your views on the design of the incentive? (eg reward/penalty/size of allowance).
- Where we set out options, what are your views on them and please explain whether there are further options we should consider.

GTQ22. What other outputs should we be considering, if any?

GTQ23. What are your views on the RIIO-1 outputs that we propose to remove?

- Safety and resilience are core competences of any infrastructure business. Strong national transmission networks remain central to the energy system.

### *Asset resilience and NARMS (Chapter 6 of cross sectoral document)*

CSQ19. Do you agree with our proposals to use monetised risk as the primary basis for network companies to justify their investment proposals for their asset management activities?

CSQ20. Do you agree with our proposals to define outputs for all sectors using a relative measure of risk?

CSQ21. Do you agree with our proposals for defining outputs using a long-term measure of the monetised risk benefit delivered through companies' investments?

- The NARMS model is a sensible evolution of the Asset Health framework and be suitable as the basis for preparing the Business Plan and judging the performance of the network going forwards.
- Absolute targets via licence conditions appears to be the most straightforward way to oversee asset maintenance.

CSQ22. Do you agree with our proposed approach to setting allowances and outputs?

CSQ23. Do you have views on the proposed options for the funding of work programme spanning across price control periods?

- A longer-term view is appropriate and would consider that 2035 is an appropriate timeframe i.e. encompassing RIIO3 and RIIO4.
- Although stakeholder engagement and willingness to pay assessment are useful, their importance should not be over stated. Some judgement is required as part of the regulatory process.

CSQ24. Do you have any views on the options and proposals for dealing with deviation of delivery from output targets?

CSQ25. Do you have any views on the interaction of the NARM mechanism with other funding mechanisms?

CSQ26. Do you have any views on ring-fencing of certain projects and activities with separate funding and PCDs? Do you have any views on the type of project or activity that might be ring fenced for these purposes?

- Some expenditure for RIIO3 deliverables should be included in baseline assumptions. Not including anything gives too much uncertainty and could constrain investment, transferring risk to network users.
- A symmetric incentive structure for NARMS is no longer appropriate given the shorter period for the price control since over delivery is less likely.
- Defining PCDs for large discrete refurbishment projects appears sensible. A governance process may be necessary for signing off delivery.

### *Safety*

GTQ24. Do you have views on whether the proposed approach on safety is appropriate for RIIO-GT2?

- Safety compliance is required on ongoing basis.

- Gas quality needs addressing under this heading and more widely in terms of future energy transition and whole system solutions. It has already been highlighted as an important stakeholder issue. GSMR is currently being reviewed although currently discussions have an overly narrow focus. A more holistic approach with more involvement from Ofgem and government would be desirable in terms of the specification and the nature of NGC's role.

## *Capability*

### Network capability

GTQ25. Do you agree with our assessment of the problems with the current arrangements, and how these problems can lead to consumer detriment?

GTQ26. Do you agree with our proposal to require NGGT to carry out an initial network capability assessment and submit the results as part of its Business Plan?

GTQ27. Do you agree that if baseline obligated entry or exit capacities are found to be at inappropriately high levels, we should consider revising them downwards in line with NGGT's proposals?

GTQ28. Do you agree with our proposal to require NGGT to review the arrangements for accessing unsold capacity?

GTQ29. Do you agree with our proposed scope for the review? Are there other aspects of access that should be reviewed at the same time

- There will not be significant changes to sources of supply or gas demand during the RIIO2 period. UKCS output will only be moderately lower by end of RIIO2 period. The UK will still be using substantial amounts of natural gas until well into 2030s. The risk of stranded assets and consumer detriment from the current arrangements is overstated.
- MERUK is an important government objective and aligned with consumer needs which benefit from diverse supplies, including indigenous gas.
- High levels of capability continue to be needed at Bacton, St Fergus and Easington which remain the main landing points for UKCS and pipeline imports. Some adjustment may be possible at other entry points.
- Variability of flows on the system is increasingly important and situations of high flow and compression requirements are not necessarily at times of peak demand. However, the regime should be robust enough to allow for a range of potential situations. An uncertainty mechanism for capability needs to reflect that maintaining sufficient optionality in the system is in the interest of consumers.
- Obligated Capacity should be retained as a licence condition. This provides certainty for market and this ultimately benefits consumers.
- NGT should continue to manage its obligations through either physical or commercial means and appropriate allowance for capacity management is needed. However, commercial interventions should be the exception rather than the rule to avoid damaging the integrity of the wholesale market
- NGC should review capability as part of the Business Plan process, and it is important to engage with users in compiling this. Consumers will not benefit if the capability regime passes risk to providers of gas and leads to less diversity of supply.
- The potential impact of proposed changes to the charging methodology is not clear. However, given that adequate capacity is available, the concept of user commitment is of limited use and the discussion in this section is contradictory. Given the variability of flows, the cost drivers are not easily attributable to different users and most are joint and common costs which cannot be allocated to individual network users or between shippers and consumers.

## *Additional outputs*

- Outputs related to improving the capacity booking system are overdue and should be included in this section; e.g. as a PCD.

## 6. Cost assessment

GTQ30. Do you agree with our intention to evolve the RIIO-GT1 approach for RIIO-GT2?

GTQ31. Do you have any comments on appropriate cost categories or approaches to cost assessment?

GTQ32. Do you agree with our proposed approach to cost categorisation? Please provide an explanation to your answer.

GTQ33. Do you support our view of the need for greater granularity and transparency in cost reporting to further develop our cost assessment capability?

GTQ34. We invite views on whether the proposed toolkit is appropriate or there are there other assessment techniques we should consider for our cost assessment toolkit in RIIO-GT2.

- Unit cost assessment, benchmarking and expert review are tried and tested regulatory tools. These are not perfect, but it is not clear that alternative approaches (e.g. competitive structures) can substitute for these in many cases.
- A variety of tools is needed with a balance between high level cost/capacity indicators and more detailed reviews in individual areas or campaigns.
- More focused assessment could be used in specific areas as this can expose where there has been innovation.
- More granularity may be needed to support assessment of projects subject to PCDs and/or uncertainty mechanisms.
- More information is required on procurement strategy as part of the Business Plan submission.
- The Business Plan needs to demonstrate the link from RIIO1 to RIIO2 and show that benefits achieved from cost reduction and innovation are now benefiting consumers



## 7. Uncertainty mechanisms

GTQ35. What are your views on the proposed uncertainty mechanisms and their design?

GTQ36. Are there any additional mechanisms that we should be considering across the sector? If so, how should these be designed

GTQ37. What are your views on the RIIO-GT1 uncertainty mechanisms we propose to remove?

Review of Agency (Xoserve) costs

GTQ38. What do you think is the most appropriate approach for funding the Gas Transporters' expenditure for Xoserve in RIIO-2? In particular, which approach do you think is in the best interest of consumers?

GTQ39. If Xoserve takes on any services beyond its core Central Data Service Provider role, how should we treat the costs and risks associated with these additional services through the price control?

- See comments below on proposed mechanisms specific to Gas Transmission

Output	O&GUK comment
Incremental capacity	A good quality Business Plan process should identify outputs clearly. A case by case approach should be taken to any unexpected items.
Compressor emission costs	See above comments to Chapter 4.
Pipeline diversion	A good quality Business Plan process should identify outputs clearly. A case by case approach should be taken to any unexpected items.
Network capability	A high degree of optionality with respect to network capability is in the interests of consumers. Once NGC review is complete this may lead to changes in allowances from Year 2 of RIIO2.
One off asset health investment	A good quality Business Plan process should identify outputs clearly.
1 in 20 flex	A good quality Business Plan process should identify outputs clearly.
Quarry/loss	This is not likely to be required.
IRM mechanism	This should be removed from RIIO2 framework.
Xoserve	New governance arrangement may justify moving to more of a cost pass through approach.

## **ANNEX B      GENERAL CROSS SECTORAL POINTS**

### **Chapters 1 and 2      General points**

The proposed regime does imply a move towards an ex-post style of regulation where many changes that require additional processes via indexing and reopeners. The proposed return on investment is relatively low and this could mean that risks are unwritten by network users and consumers in the event of changed conditions. There is a risk that this will lead to an overly cautious approach to investment and innovation.

Customers benefit from diverse supplies and active and vibrant market. Although regulated businesses should be incentivised to achieve cost efficiency, the delivery of outputs that improve the efficiency of the market are equally likely to be in consumers interests.

Network businesses can and must have a role in facilitating the energy transition. However, this is a long-term process and for the period covering RII02 there are unlikely to be radical changes to the energy system. Households and business will continue to be dependent on natural gas for a range of services especially for providing heat.

Ofgem should continue to make the case for effective and independent regulation. Although there has been continual evolution, the basic concepts developed since privatisation continue to be valid. The framework has evolved sensibly over time and demonstrably delivered in terms of investment and increased efficiency and innovation. A consistent cross sectoral approach is to be commended as allows an overarching approach to be developed.

Our sector continues to participate separately in the Gas Charging Review. Both for this exercise and RII02, it is important to keep in mind the changing dynamics of the gas transmission network. Reductions in demand and an increase in the range of supplies has led to more variable flows across the whole network. This fundamentally changes and complicates questions of cost allocation with a larger element being common to all market participants. It is important that the regime does not unduly disadvantage indigenous production and supports the government's MERUK objective.

### **Chapter 3      Giving Consumers a Strong Voice**

We support a stronger stakeholder processes and the development of the Stakeholder Panels. These have provided a good vehicle for feeding in industry views and they could potentially form an ongoing part of the framework, for example for assessing delivery of PCDs.

### **Chapter 4      Reflecting what consumers want (CSQ2-7)**

Definition of the three key overarching outputs for the regulated elements of the value chain ("outcomes") is welcome and helps develop certainty.

The definition of the three different types of delivery mechanism (LCs, PCDs and ODIs) is reasonably clear. It is preferable to have a much ex-ante certainty as possible such that PCDs and the associated expenditure is allowed for in the price control. Uncertainty mechanisms should be used sparingly to avoid the gradual drift towards ex-post rate of return regulation and regulatory "sign-off" of individual projects.

The number of ODIs should be reduced especially those which involve scoring or subjective judgement. Some appear to be too small to really make a difference to behaviours or are for things outside NGC's control. Other items potentially duplicate other requirements outside the regulatory regime and should be reviewed to assess potential overlaps (for example carbon reporting). The term ODI should be restricted to only those items which are subject to financial incentives.

The concept of “dynamic” incentives appears over complicated and risks being an opaque structure, especially for presentation to consumers and wider stakeholders.

## **Chapter 5      Whole system solutions (CSQ8-18)**

At present, the concept of “whole system solutions” is not particularly clear. For example, it is different to see how the structure set out in paragraph 5.11 will be implemented in practice. One (incorrect) interpretation of this section is that regulated business can solve almost any issue with an appropriately joined up regime. However, it is more likely that opportunities of this type will be more limited and bespoke, which suggests a narrower focus is needed.

## **Chapter 6      Safety and resilience (CSQ19-34)**

See Annex A for comments on Asset Resilience. We do not have additional comments on the other areas.

## **Chapter 7      Managing uncertainty (CSQ35-43)**

Please see comments on Annex A with respect to gas transmission.

As an addition point, the concept of a utilisation incentive or “risk sharing approach” is potentially damaging to investment incentives as it creates regulatory uncertainty and will slow down decision making. As discussed in Annex A the risk of stranded assets is overstated and the greater potential damage to consumers' interests would arise from a system with insufficient capability to deal with a variety of circumstances.

## **Chapter 8      Driving innovation and efficiency (CSQ44-64)**

As a principle, the move to a more BAU approach is to be welcomed and the associated removal of the IRM mechanism is sensible. Overall, a more strategic approach is needed as part of the Business Plan process.

The potential funding pot to support Energy Transition is desirable. With respect to gas, this is particularly needed for continuing with hydrogen demonstration projects.

The NIA framework and involvement of third parties potentially creates issues and conflicts around intellectual property. It is not that clear how these will be managed.

With respect to competitive delivery, it is not clear that either the “early” or “late” approach are relevant for gas transmission. If anything, a “late” competition element for gas transmission should be focused on assessing NGC procurement strategy as part of Business Plan and cost assessment. Special Purpose Vehicles are not the only model and there are a large range of risk sharing structures that are possible. There is not a strong rationale for the ESO to be involved in the gas transmission process.

## **Chapter 9      Business Plan assessment (CSQ65-80)**

The new engagement structures should reduce the risk of a “poor” Business Plan being submitted and supersede the IQI framework which can be removed. Some financial incentive may be appropriate but there should increasingly be a strong reputational element to the oversight of the Business Planning process. The argument for different regimes for individual deliverables in terms of a variable sharing factor does not really fit in with the goal of a simplified framework.

## **Chapter 10      Fair returns (FQ1-37, CSQ81-89)**

Please refer to our comments to the April 2018 consultation (attached at Annex C).

## **Chapter 11      Ensuring a reasonable balance (CSQ90-98)**

Please see comments to Chapters 1-2.

## **Chapter 12      Impact assessment (CSQ99-102)**

Impact assessment should be based on the three overarching output categories rather than a detailed assessment of each individual element. It is important to remember that networks are only part of the energy value chain and an important part of their role is to facilitate effective competition so that other market participants can deliver beneficial outcomes for consumers.

## ANNEX C OIL AND GAS UK RESPONSE TO MARCH 2018 CONSULTATION

Oil & Gas UK  
2<sup>nd</sup> Floor  
The Exchange 2  
62 Market Street  
Aberdeen AB11 5PJ

Telephone +44 (0)1224 577 250  
Fax +44 (0) 1224 577 251  
Email [info@oilandgasuk.co.uk](mailto:info@oilandgasuk.co.uk)

[www.oilandgasuk.co.uk](http://www.oilandgasuk.co.uk)

To be sent electronically to: [RIIO2@ofgem.gov.uk](mailto:RIIO2@ofgem.gov.uk)  
2 May 2018

### Oil & Gas UK response to the Ofgem RIIO2 Consultation

#### About Oil and Gas UK

Oil & Gas UK is the leading representative body for the UK offshore oil and gas industry with over 350 members. Our aim is to strengthen the long-term health of the offshore oil and gas industry in the United Kingdom by working closely with companies across the sector, governments and all other stakeholders. We, on behalf of our members, appreciate the opportunity to feed into Ofgem's approach to the RIIO-2 price controls.

The oil and gas sector is a UK industrial success story, supporting some 330,000 jobs (direct, indirect and induced) across the UK. The industry is a centre of excellence and expertise for offshore technologies and subsea engineering and has supply chain exports worth £12 billion per annum to the UK economy. The oil and gas industry not only makes a vital contribution to the economy and the UK's security of energy supply, but it also possesses significant opportunity to help achieve the UK's climate change targets.

This response largely concentrates on issues relating to the gas transmission network which has the most direct impact on Oil and Gas UK members. Where appropriate, comments are also provided on some overall regulatory principles and market design issues. The responses are grouped by each Chapter of the consultation

#### General Issues

##### *Implications of the Infrastructure Act 2015*

This legislation created a new framework for the offshore oil and gas sector by creating an independent regulator, the Oil and Gas Authority, and confirming the overarching primary objective on operators to act in a way consistent with maximising economic recovery of the resources of the UK Continental Shelf ("the MERUK Objective"). These obligations are codified in the MERUK Strategy which imposes detailed obligations on operators.

Although Ofgem has its own statutory duties, consideration needs to be given to the alignment of the regulatory framework between the upstream and downstream elements of the UK gas market. These are not inconsistent, since it is in the interests of consumers to have available a wide range of sources of gas, including indigenous production. The RIIO-2 framework should therefore seek to facilitate sufficient ongoing investment in the maintenance and secure operation of the transmission network in order to continue to support UKCS production.

## *Maintaining a liquid and competitive gas market*

The maintenance of an open and liquid wholesale market for gas, with clear price signals is a key feature of the UK market and one which the regime for gas transmission must continue to facilitate. To some extent this is more important, from a consumer perspective, than the achievement of relatively marginal gains in terms of the approach to efficiency targets or revisions to the approach for outperformance incentives.

Recent developments in the gas market, in particular the substantial reduction in UK gas demand, has meant that the issues facing the transmission system have changed compared to expectations at previous reviews. There is generally sufficient transmission capacity to meet the needs of network users and consumers for the foreseeable future. Therefore, the focus of the regulatory regime needs to evolve to reflect this new position and also consider how the network should meet the changing nature of gas supply.

The current gas charging review is already considering some of these issues by potentially revising the nature and extent of the locational signals given to network users. For a network where capacity constraints have less impact, the case for the targeting of costs to particular classes of users is not as strong. The RIIO-2 regime and the associated charging structure should therefore more clearly recognise the integrity of the network as a whole and adopt a more system wide view of the cost and benefits to users and consumers.

## *Energy transition and the future of gas*

The RIIO-2 period will also encompass the ongoing transition of UK energy provision of which gas will continue to form an important part. There is considerable scope for increased use of gas in the UK for electricity generation and transport as well as its continued primary role in the provision of heating to households and industry. Recent research has demonstrated that continued use of gas for these purposes is likely to be lower cost to consumers than alternative technologies given the cost of some of the required upgrades to electricity networks.

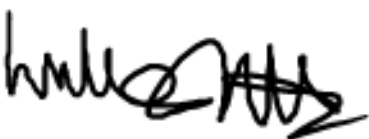
The RIIO-2 review also needs to reflect the prospect of future technologies relating to Carbon Capture Usage and Storage (CCUS) and the use of hydrogen in the gas network. This may require NGC to accept a wider gas specification or to provide a blending service. Indigenous gas is already being lost to UK consumers due to the absence of such requirements. The regulatory regime for these services needs greater scrutiny and clarification as part of the forthcoming review process, including consideration of revisions to the gas transmission licence.

## Summary

Overall, the Ofgem consultation is a good basis for the main issues to examine the relevant issues for the RIIO-2 price controls. As discussed above we consider that additional emphasis could be given to the ongoing need to ensure the attractiveness of the UK market as a destination for investment and gas supply. Although it is important for network business to be managed efficiently and for potentially excessive returns to be controlled, the role of NGC in providing service to an efficiently functioning gas market are also of high importance to consumers and the need for investment to maintain this is an important part of the regulatory framework.

We trust you will find our response helpful. Should you require any further information or have any queries on the above points, please don't hesitate to contact me at [wwebster@oilandgasuk.co.uk](mailto:wwebster@oilandgasuk.co.uk).

Yours faithfully,



William Webster  
Energy Policy Manager



## ANNEX: RESPONSE TO QUESTIONS ON SPECIFIC ISSUES

### Chapter 3 Reflecting the views of network users and consumers (Q1)

We support the proposals set out in the Consultation to have greater stakeholder involvement. For transmission, there is a strong value in dialogue between NGC and network users via a User Group. Regulatory approaches such as the CAA's constructive engagement process have been relatively successful in formulating the approach to capital expenditure and could potentially deal with issues around perceived excessive returns and uncertainty about the scope of the investment programme. Likewise, engagement with network users can also help deal with the boundaries between, for example, activities which are regulated versus non-regulated activities. Open Hearings could also be useful in dealing with areas of contention but would require a clear Terms of Reference and governance process.

### Chapter 4 Responding to how networks are used (Q2- Q10)

We support the potential shift to a shorter price control period. Experience with RIIO-1 suggests that there are too many uncertainties associated with longer price control periods and this makes it difficult to develop a stable package of outputs and costs as part of the regulatory contract.

Ofgem should deal with questions relating to "whole system outcomes" on a case by case basis rather than trying to build these into the overall regulatory regime. There is also currently considerable uncertainty about the extent of such issues and they may not affect the overall scope of the price control. Furthermore, the current legislative and regulatory regime is predicated on a disaggregated commercial framework and unless this changes fundamentally the regulatory regime should concentrate on the basics of the price control process. With this in mind, we do not support separate remuneration models for the gas TO and SO and agree with the proposed approach.

In relation to "stranded costs" we would disagree with the premise that consumers require additional protection. This will increase uncertainty and potentially distort investment decision making. The network needs to be maintained to meet consumers' needs in a wide variety of different circumstances and retrospective judgements about whether investments have been efficiently incurred should not be used as part of the basic regulatory framework. Many of these issues could be dealt with through a more comprehensive stakeholder process as set out in Chapter 3.

With respect to energy efficiency and decarbonisation of heat, the focus of the network businesses and their regulatory framework should be to support investment in the network. This may, for example, include the scope to deal with a wider range of gas quality parameters. As Ofgem notes, future uncertain and challenges may come from scenarios where use of natural gas will be higher rather than lower. Network companies are not primarily responsible for encouraging reduction in energy use which will result from individual consumers' own choices and their relationship with suppliers. It is not appropriate for the network regulation regime should not second guess particular outcomes.

### Chapter 5 Driving innovation and efficiency (Q11-18)

In general, we would agree with Ofgem's premise that innovation should increasingly part of the BaU activities of network operators, particularly in support of the energy transition and future use of gas networks including issues relating to gas specification. Greater stakeholder involvement in the development of innovation support using the structures discussed in Chapter 3 would be helpful to ensure research is in the interests of consumers.



We would agree that competition has provided benefits in specific cases where new, separable and high value investment has been delivered at lower cost than would otherwise be the case. To some extent this is a tried and tested model since the offshore gas network regime has been developed through a competitive framework. We would support the extension to gas transmission; e.g. for connections to new LNG terminals, but it is not clear at this stage whether there are currently projects that would meet the criteria.

## **Chapter 6      Simplifying price controls (Q19-32)**

The proposals relating to “price control deliverables” are not particularly well explained. More detail is needed of the mechanism for recognising “delivery” of particular outputs. In order to be an automatic process, the definition of the output required would need to be unambiguous and objective. However, this could imply a relatively narrow definition which may not be consistent with a wider benefit in terms of consumer outcomes. The stakeholder engagement process may be a way of dealing with this issue. Recognition of specific high value deliverables could be dealt with, for example, through a modified framework for capital expenditure. But this would require a case by case assessment of the outcomes and efficiency of expenditure on an ex-post basis rather than taking the capital programme as a whole.

Cost indexing may be possible but, as with service performance, it may also be problematic to define indices that are relevant in all circumstances. Introducing too many avenues to reopen or index prices controls may make the regime more complicated and uncertain rather than being a simplification.

With respect to information revealing devices and the business plan process. We would generally agree with the direction of travel away from mechanistic devices such as IQI and in favour of stronger engagement and a greater degree of commitment by Boards of Directors to the quality of the Business Plan. Reputational incentives may be stronger than crude financial rewards. We would agree with the removal of “fast tracking” for transmission although we would still expect there to be both a Draft and Final Business Plan to be produced. This is not clear from the consultation document.

## **Chapter 7      Fair returns and finance-ability (Q33-46)**

We would expect Ofgem to take account of recent developments in financial markets, best practice from other regulators and the decisions of the CMA in regulatory determinations and appeals. The estimation of betas for network businesses would appear to be a key determinant of estimated equity costs and have the most impact on charges. With respect to corporation tax, it would appear to be difficult for Ofgem to deal with this issue easily since the tax regime may change during the price control period.

On the subject of ensuring fair returns, we would urge some caution in using the experience in RIIO-1 to guide policy in RIIO-2 since the challenges will inevitably be different. Some of the issues during RIIO-1 may be addressed by moving to a shorter regulatory period and the realisation on efficiency gains in the RIIO-1 period in the starting position for RIIO-2. Increasing complication of the incentive regime will make it less clear to the regulated business what it is expected to achieve and dampen the search for efficiency improvements and cost savings.

There is however some merit in dealing with issues where there is a significant level of uncertainty relating to cost and/or scope at the time of the review. As discussed above, this may require modification of the capital expenditure regime towards a case-by-case assessment of efficiency and delivery as used by other regulators.

## Chapter 8      Next steps (Q47-50)

With respect to the gas transmission, the key issues relate to the need to maintain a liquid and attractive market and to encourage a wide range of sources of supply, including from indigenous production. In this regard, the licence requirements with respect to Obligated Capacity should be retained and maintained at the same level.

Looking forward, the potentially increased role for gas in the low carbon economy should be recognised and the regulatory regime must ensure that the full range of technology options for lower emission technology are maintained.

Finally, the regime should also seek to better facilitate a wider range of gas quality specifications and provide a clearer framework that gives National Grid incentives to provide suitable service for blending. This is already a matter of some urgency for investors in some UKCS fields. The attached briefing provided by one of our members sets out the current issues in more detail.