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15th October 2019

Dear colleagues,

I am responding on behalf of the Scottish Government to Ofgem's Open Letter Consultation on approach to setting the next electricity distribution price control (RIIO-ED2), issued on 6th August 2019.

On 25th September 2019, the Scottish Parliament passed the **Climate Change Bill** which puts into law a target of net-zero greenhouse gas emissions for Scotland in 2045, five years ahead of the targets for the UK as a whole and in line with advice from the Committee on Climate Change. The Bill also sets an interim target of a 75% reduction in GHG emissions by 2030. It builds on a wide range of existing ambitions, targets and policies which are unique to Scotland, and which collectively strengthen Scotland's international leadership on climate action. The actions relevant to the energy sector are set out within our Scottish Energy Strategy.

The Scottish Energy Strategy (our Strategy) sets out our vision for the future energy system in Scotland.[1] It articulates a vision built around our priorities, many of which are in line with wider Ofgem priorities, and in tune with the wider direction of travel across the UK. Scotland's energy networks will play a vital part in delivering our Strategy, and the transition towards a low carbon future. It is crucial that they are developed and funded in a way that recognises the key role they play in the energy transition, and capable of delivering a sustainable, low carbon future. This will be consistent with our ambitions, allowing us to deliver on our commitments to Scotland while supporting the decarbonisation of the energy system across Great Britain.

[1] The Scottish Energy Strategy, Scottish Government, December 2017. Available here: https://www.gov.scot/Publications/2017/12/5661/downloads.

Our Vision for Scotland's Electricity and Gas Networks,[2] published earlier this year, sets out in detail how we think our energy networks need to develop, in a way which is consistent with the priorities in our Energy Strategy. In particular, it sets out our desire for:

- an electricity distribution network with sufficient capacity to meet the continuing growth of distributed generation, and capable of carrying clean electricity to and from new demand across these networks, including electric vehicles and a growing number of heat pumps.
- a Distribution System Operator (DSO) transition which engages and rewards consumers where appropriate, manages risk effectively and ensures safety, security, efficiency, openness and flexibility.
- demand management, new platforms and technologies to help manage peaks in local demand and generation in ways that deliver greater value to local communities and support resilient supplies.

We believe that responding to the global climate emergency represents a vital duty for all of us. Consumers will need an electricity network capable of delivering these targets, supported by a regulatory framework that acknowledges the long term nature of the challenge. Ofgem needs to set clear expectations through RIIO-ED2 on how DNOs can deliver this efficiently and economically, both within the ED2 period and beyond.

We agree with Ofgem that the process and settlement must balance the vital need to decarbonise our energy system and economy with the need to protect, and deliver value for, consumers – especially those considered vulnerable. We also support efforts to create a much better understanding of how to balance the interests of today's consumers against those at different points in the future; it is critical that Ofgem balances the need to deliver value for money for current consumers with ensuring sustainability for future consumers.

Our Networks Vision highlights the increasingly important role which "anticipatory" investment is likely to play – i.e. circumstances or areas where early network investment is needed to accommodate new electrical generation or demand, rather than the traditional approach of delaying network investment until demand comes forward. The approach to this issue will require careful co-ordination and collaboration between the regulator, stakeholders and government – balancing the risk of stranded assets against the risk that insufficient network capacity acts as a major barrier to decarbonisation ambitions.

Decarbonising transport and heat will be vital; the electricity network must be able to support the increased demand that growth in these areas will create. This includes enabling the rapid rollout of low carbon technologies, including heat pumps and electric vehicles (EVs), the latter alongside an EV charging network which can accommodate and support them. Achieving this will require innovative approaches to

[2] A vision for Scotland's electricity and gas network, Scottish Government, March 2019. Available here: https://www.gov.scot/binaries/content/documents/govscot/publications/publication/2019/03/vision-scotlands-electricity-gas-networks-2030/documents/vision-scotlands-electricity-gas-networks-detail-2019-2030/vision-scotlands-electricity-gas-networks-detail-2019-2030/govscot%3Adocument

make the most effective use of new and existing network capacity, balancing costs and benefits to today's consumer against those of future consumers and society as a whole.

While smarter ways to use capacity are important, consumer confidence throughout this process will depend on maintaining a reliable network, which remains fit-for-purpose and capable of supporting real-time increased demand for electricity.

Our view remains that Government – national, devolved and local – has an important role to play in reducing the uncertainty over the future of the energy system. The Scottish Government is keen to continue to develop and maintain an effective and constructive relationship between Ofgem and government at all levels. In the annex to this letter we highlight some areas of particular importance to the Scottish Government, and some devolved responsibilities which Ofgem should consider as RIIO-ED2 is developed.

Your open letter highlights the substantial impact that electricity distribution is likely to experience as a result of decarbonisation. This relationship can also work in reverse, with appropriate distribution networks able to facilitate those low carbon technologies. We welcome your openness to new ideas in terms of the role and responsibilities of DNOs within the energy system.

On this point, the Scottish Government recently announced an EV Strategic Partnership with the Scottish network companies. This reflects our view that Government, network companies and other stakeholders will need to work more closely together to identify and deliver coordinated infrastructure investments.

I have included a copy of the recent letter from Michael Matheson, Cabinet Secretary for Transport, Infrastructure and Connectivity to Jonathan Brearley in a separate annex to this letter. We are keen to discuss further how our ambition and approach can fit within the regulation and funding structures currently in place, and will include this as a key component of our engagement with Ofgem as the RIIO-ED2 process and debate continues.

Kind regards,

Neal Rafferty
Head of Electricity Policy

ANNEX 1 – SCOTTISH GOVERNMENT PRIORITIES AND RESPONSIBILITIES

There are several differences in terms of the Scottish Government's ambitions, targets and priorities compared to the UK Government, as well as some relating to the relevant devolved powers and responsibilities. We will aim to follow up on this initial response with a separate paper for Ofgem, describing our devolved areas of responsibility and their relevance to RIIO-ED2 in a little more detail.

We consider it important for Ofgem to explicitly acknowledge, understand and take account of these aspects when assessing the business plans of network companies operating in Scotland. Key areas and ambitions include:

- Our ambition to **phase out the need for petrol and diesel cars and vans by 2032**, as set out in the 2017/18 Programme for Government.

- The commitment through our Energy Efficient Scotland Programme to make **our homes and buildings warmer, greener and more efficient by 2040**, eliminating poor energy efficiency as a driver of fuel poverty and reducing greenhouse gas.

- Our target for **100% gross annual electricity consumption in Scotland to come from renewables by 2020**.

- Our goal to see **11% of Scotland's non-electrical heat demand to come from renewable sources by 2020**.

- The target in Scotland's Energy Strategy for **the equivalent of 50% of the energy needed for Scotland's heat, transport and electricity consumption to be supplied from renewable sources by 2030**

- Our commitment to **smarter local energy** – including allowing local priorities and community and regional level to flourish. **We want to see 1GW of local and community energy by 2020 and 2GW by 2030**.

These ambitions are all reflected within our 2018 Climate Change plan, which set out how we will meet our statutory target to reduce greenhouse gas emissions by 66% by 2032. **However, Scotland's Climate Change Plan will now be updated following the recent passage of the Climate Change Bill through the Scottish Parliament**. The Bill, as approved by the Parliament on 25 September, sets a legally-binding "net-zero" target of 2045 – five years ahead of the rest of the UK. The Bill also commits to a 75% cut in emissions against 1990 levels by 2030; the Scottish Government will now commission new advice from the Committee on Climate Change on the pathway towards this point.

Consumers

We want to transform the way consumer issues are understood and tackled in Scotland to deliver a transparent market promoting consumer fairness and trust.

At the heart of the Scottish Government's Energy Strategy is a commitment to **"promote consumer engagement and protect consumers from excessive or avoidable costs, prevent new forms of social exclusion and promote the benefits of smarter domestic energy applications and systems"**.

In May 2019, the First Minister launched the Energy Consumer Action Plan setting out a collaborative approach to ensuring that consumers are informed, engaged and empowered as the energy system evolves. Actions include:

- establishing an independent Scottish Consumer Commission to give consumers a more powerful voice in Scottish and GB energy policy;
- developing an energy consumer charter for Scotland to support the collective effort needed to address the issues that impact Scottish consumers;
- promoting lively public debate that allows the people of Scotland to shape their energy future.

Heat decarbonisation

As Ofgem's open letter highlights, heat decarbonisation has significant implications for energy networks. Heat and energy efficiency policy are areas of devolved responsibility and it is important that the RIIO-ED2 framework reflects this.. Any assumptions for any increase in electricity demand associated with heating should take account of Scottish Government targets, funding and policy, particularly where this is distinct from UK policy.

Any uncertainty mechanisms associated with heat policy should also, for distribution networks in Scotland, be able to reflect and take into account decisions taken by the Scottish Government and Scottish Parliament. Areas where there are substantial devolved responsibilities include:

- building standards (domestic and non-domestic buildings);
- housing regulation;
- renewables support;
- development planning;
- heat network regulation;
- the public sector; and
- climate change policy.

The price control outcome should ensure that network companies act in line with, and are able to contribute fully towards, the high levels of ambition for heat decarbonisation in Scotland.

We will publish a **heat decarbonisation policy statement** in summer 2020, setting out a vision and programme for decarbonising heat and early announcements on

heat decarbonisation were made in the **2019/20 Programme for Government (PfG)**[3].

The 2019/20 PfG commits us to scale up and accelerate existing work so that we reduce emissions from heating our homes and buildings to near-zero by 2045. It includes the commitment to develop regulations so that new homes consented from 2024 are required to use renewable or low carbon heat, in line with advice from the Committee on Climate Change.

Local Heat and Energy Efficiency Strategies

We are also currently working with local authorities to pilot **Local Heat and Energy Efficiency Strategies (LHEES)**. LHEES will support a coordinated approach to the local planning and delivery of energy efficiency and heat decarbonisation programmes within Energy Efficient Scotland, and to ensure that national level policies and ambitions are delivered on the ground. We believe that the requirement for local authorities to produce LHEES would be best placed on a statutory basis, and will work with local authorities to agree the best way to do this.

We expect LHEES to play an important role in coordinating a wide range of activities to support heat decarbonisation, including network investment decisions – that's why we were pleased to note that Ofgem has recognised this as a valuable process in the September update to its Business Plan Guidance.

<u>We believe that the process of developing and agreeing business plans through RIIO can help guide companies across all regulated energy network sectors to engage meaningfully in the development of LHEES</u>.
This includes sharing early-stage planning for changes to the network, sharing data, regular discussions on future load, pro-actively making advice available about network capability and capacity in relation to particular local authority proposals, and responding to relevant local authority consultations. We would also want to see similar levels of engagement with local energy groups such as Community Energy projects.

Installation of renewable heat technologies

Heat decarbonisation is likely to lead to a significant increase in the rate of heat pump installations. Along with growing demand for connecting EV charging infrastructure (both domestic and public), this is likely to require the development of processes and arrangements for connection to the distribution network. This could include DNOs offering faster and more tailored services to customers looking to increase their connection capacity, the proactive highlighting of connection opportunities, or identifying additional customers who might be willing to share reinforcement costs with the initial applicant.

The price control should guide DNOs to work with stakeholders (including Scottish Government and local authorities) to identify and develop changes to connection

[3] https://www.gov.scot/publications/protecting-scotlands-future-governments-programme-scotland-2019-20/

procedures. It should also retain sufficient flexibility in allowances to ensure that these can be funded.

Electric vehicles

The Scottish Government has committed to phase out the need for new petrol and diesel cars and vans by 2032, eight years ahead of the rest of the UK. To support this commitment, the Scottish Government has invested over **£30 million** in ChargePlace Scotland, Scotland's publicly available Electric Vehicle (EV) charging network, which is now one of the most comprehensive charging networks in Europe.

We recognise that moving from EV early adopter to a mass market poses challenges for the planning and operation of our electricity networks. This was highlighted in our *"Vision for Scotland's Electricity and Gas Networks to 2030*".

We recently announced a new Strategic Partnership between the Scottish Government, Scottish and Southern Electricity Networks (SSEN) and Scottish Power Energy Networks (SPEN). The **£7.5 million** partnership includes Scottish Government funding of £5 million, and at least an additional £2.5 million from the network companies to deliver trial projects in 2020-2021, aimed at demonstrating the benefits of coordinated planning and investment in electricity and EV charging infrastructure.

We highlighted this theme as part of our response to Ofgem's informal consultation in June this year on SPEN's proposed RIIO-ED1 price control reopener to fund the Accelerated Electric Vehicle Investment High Value Project. Our response expressed clear support for the principle of investing ahead of need, where a balanced and demonstrable case exists to do so, in order to facilitate the growth of EV numbers.

We believe that this will remain a critical aspect of delivering an electricity distribution system capable of supporting our energy and transport decarbonisation ambitions. Ofgem's recognition of the potential need for and role of strategic investment in August's open letter is welcome and important; the Scottish Government agrees with that recognition, while also recognising the need to manage the associated uncertainties.

Building on the premise of our Strategic Partnership, we would also support an exploration of the potential role of DNOs in installing and operating EV charging infrastructure – for example, where it is apparent that the market may not deliver the necessary outcomes purely on its own. Ministers are keen to avoid circumstances where certain parts of the country are left behind, and would like to see an open and constructive approach to the regulatory questions which might allow DNOs to play a role here

We will be keen to discuss and to take an active part in identifying and agreeing possible approaches to all of the matters above with Ofgem, the network owners and other key stakeholders.

National planning framework

Scotland's third National Planning Framework[4] set out our desire to live in sustainable, well-designed places and homes, within a low carbon economy that achieves growth whilst reducing emissions. Planning policy has been fully devolved since 1998, with preparation of the fourth National Planning Framework (NPF4) now beginning to get underway – a process which will require wide-ranging stakeholder engagement. The NPF4 should be in place in 2021, with any relevant aspects thus able to help inform the RIIO-ED2 price control period from April 2023.

Control of woodland removal policy

When woodland removal is associated with development, the relevant planning authorities or, in the case of deemed planning permission for applications made under the Electricity Act 1989, Scottish Ministers, are required to determine applications in line with Scottish Government's Policy on Control of Woodland Removal[5].

This can require companies to undertake compensatory planting for the areas of woodland that are felled to construct new networks. As such, it presents an additional cost in the context of certain developments, and which must be taken into account as part of the business planning process.

Fuel Poverty Policy and Fuel Poverty Definition

Scotland has a different Fuel Poverty Policy and fuel poverty definition compared with England and Wales. The Scottish definition is expected to be revised this year through the Fuel Poverty (Target, Definition and Strategy) Scotland Bill[6] which is currently with the Scottish parliament. This will define Fuel Poverty in terms of:

- the ratio of the cost of fuel needed to heat the home to net income, after housing costs;[7] and

- an income threshold defined for different household types.

[4] Available here: https://www2.gov.scot/Resource/0045/00453683.pdf.
[5] Available here: https://scotland.forestry.gov.uk/images/corporate/pdf/control-of-woodland-removal.pdf
[6] https://www.parliament.scot/parliamentarybusiness/Bills/108916.aspx
[7] Housing costs includes rent or mortgage, council tax and charges for water and sewers.

Households must fulfil both conditions to be considered in fuel poverty. The Scottish Government will also be setting out the actions it will take to deliver the targets set out in the Bill in a new Fuel Poverty Strategy, likely to be published in 2020.

Ofgem and the network companies should understand and take into account these important and substantial differences, including (on Ofgem's part) when making comparisons across GB. This will help ensure that its approach is sufficiently flexible to accommodate and recognise the different definitions in Scotland.

ANNEX 2 – LETTER FROM CABINET SECRETARY FOR TRANSPORT, INFRASTRUCTURE, AND CONNECTIVITY TO JONATHAN BREARLEY, 10th OCTOBER 2019

Cabinet Secretary for Transport, Infrastructure and Connectivity
Michael Matheson MSP

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Jonathan Brearley
Executive Director for Systems and Networks
Ofgem
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10th October 2019

Dear Jonathan,

I am writing to you following the launch of our Electric Vehicle (EV) Strategic Partnership with SP Energy Networks and Scottish and Southern Electricity Networks, announced by the First Minister on the 29th August.

The ambition we have for the decarbonisation of transport in Scotland means we need to work even more closely with the electricity networks sector, including Ofgem, in order to deliver a sustainable transport system. It is important that investment in electricity networks is coordinated with the growth and development of EV charging. I am keen to work with you to ensure that a flexible regulatory system can accommodate Scotland priorities both within transport, and across the wider energy system.

Our Strategic Partnership involves a joint commitment of £7.5 million. It aims to explore new ways of coordinating the development and delivery of EV charging and Electricity

Network infrastructure in order to ensure efficient investment and a fair distribution of cost across electricity consumers, EV users and society as a whole. The Scottish Government aims for access to EV charging infrastructure for everyone, facilitating a transformation of the transport system which supports a successful, inclusive and low carbon society.

This partnership is a central building block in our commitment to phase out the need for new petrol and diesel cars and vans in Scotland by 2032, eight years ahead of the UK target. Developing a world leading electric vehicle charging network will be central to meeting this ambition.
Today, the ChargePlace Scotland network provides an outstanding publicly financed network of more than 1000 public chargers, with comprehensive coverage across the whole country. As the number of EVs in Scotland increases, our aim will be to ensure that the infrastructure keeps pace.

Suitable electricity networks are a prerequisite to delivering energy to EVs, and as their use becomes more widespread there will be growing pressures on distribution networks at all levels. Aligning the location, size and flexibility of EV chargers with the capability of the electricity networks will lead to an efficient and cost-effective outcome for electricity consumers, EV owners and society as a whole.

Decarbonising transport is one part of our wider energy and climate change ambitions. Our Energy Strategy commits us to ensuring that the equivalent of 50% of all our energy – across heat, transport and electricity – comes from renewables in 2030, and the Climate Change Bill recently passed by the Scottish Parliament commits Scotland to become a net-zero society in 2045, five years before the rest of the UK in line with advice from the Committee on Climate Change. The Bill also set a target to reduce greenhouse gas emissions by 75% by 2030, the most stringent 2030 target in the world.

Electricity networks will be central to delivering on all of these targets, something that our Vision for Scotland's Electricity and Gas Networks highlighted earlier this year. That vision emphasises the need for us to work closely with network companies, with Ofgem and with a range of key stakeholders to ensure that our energy networks can facilitate Scotland's ambition.

We understand the challenges that the electricity network sector faces as a key enabler of transformation in Scotland's energy and transport systems. Ofgem's role will be critical, in particular through the price control agreements that you will negotiate on behalf of electricity consumers. The process of developing RIIO-ED2 will set the structure within which distribution networks invest in and develop their networks during the 2020s. We are pleased to see the focus Ofgem puts on open and constructive engagement in its open letter on ED2, and we will be responding to that consultation shortly – highlighting the particular ambitions and targets that we have in Scotland.

I am keen to discuss these issues with you in more detail, and to explore how we can best work together to support the coordinated development of electricity networks and EV charging infrastructure across Scotland.

My officials will be in touch and I hope we will be able to arrange a mutually convenient time.

MICHAEL MATHESON
Cabinet Secretary for Transport, Infrastructure and Connectivity