

To all interested parties

Email: RIIO-ED1@ofgem.gov.uk

Date: 8 February 2021

Open letter on the Energy Network Association (ENA) Green Recovery Scheme

This open letter welcomes the launch of the ENA Green Recovery Scheme and provides an overview of how it will work. The letter also seeks views on how the ENA Green Recovery Scheme will fit with our regulatory framework.

Background

In December 2020, the Committee on Climate Change announced the 6th Carbon Budget in which they recommended that polluting emissions in the UK must fall by almost 80% by 2035, while 60% of the necessary emissions reduction to 2050 will need to be achieved over the same 15 year period.¹ This comes in the wake of the UK Government's 10 Point Plan for a Green Industrial Revolution,² which has now been followed by the UK Government Energy White Paper³ and the Scottish Government Climate Change Plan Update.⁴

Confirmation of these climate change ambitions and targets show the need to deliver substantial decarbonisation in several sectors, each of which will have a significant impact on electricity distribution networks over the next 10 years.

Within this context, we are thinking hard about our vision for a greener, fairer future and ensuring that we can proactively lead change and play a full part in an accelerating energy market and green economic recovery.

¹ <https://www.theccc.org.uk/publication/sixth-carbon-budget/>

² <https://www.gov.uk/government/publications/the-ten-point-plan-for-a-green-industrial-revolution>

³ <https://www.gov.uk/government/publications/energy-white-paper-powering-our-net-zero-future>

⁴ <https://www.gov.scot/publications/securing-green-recovery-path-net-zero-update-climate-change-plan-20182032/>

Driving a green economic recovery

During 2020 the energy networks and ourselves came together to develop a collaborative model to tackle the Covid-19 crisis, maintaining security of supply and high levels of system reliability, continuing to provide essential services to consumers, while ensuring safety for all.⁵

Building on the success of this model, we invited the networks to work together, through the ENA, to identify measures targeted towards accelerating net benefits to consumers, through decarbonisation of the energy networks, while also making a contribution to a green economic recovery. This included proposals to:

- enable the fastest possible ramp-up of investment programs that had to be scaled back to accommodate Covid-19 restrictions
- accelerate planned work from future years to start now to help reactivate supply chains and deliver earlier benefits to consumers.

Within the current RIIO price controls, over £2bn worth of projects across the gas and electricity networks are reactivating supply chains and helping drive overall economic activity now as well as delivering key benefits for energy consumers.

In the RIIO-ED1 price control, which runs until April 2023, the Distribution Network Operators (DNOs) accelerated £80m of projects to start in 2020, bringing forward planned investments from future years to support new connections as well as preparing the grids for Net Zero and the predicted increases in electricity demand, including from electric vehicles (EVs) and heat pumps.

In addition to these existing commitments, and in the context of recent Government climate change ambitions for the sector, we invited the DNOs to consider appropriate opportunities to enable new and accelerated investment to support future user needs and decarbonisation.

ENA Green Recovery Scheme

In response to the request from us, the ENA has supported the development of a coordinated whole systems approach to accelerating low regrets network investment under the RIIO-ED1 price control to support an equitable transition and stimulate economic recovery and low-carbon development; “the Green Recovery Scheme” or “the Scheme”.

⁵ <https://www.ofgem.gov.uk/coronavirus-covid-19/coronavirus-covid-19-information-energy-licensees-and-industry>

Under the current regulatory framework there is scope for DNOs to undertake investment ahead of demand but there are a number of factors that limit this. This includes consideration of risk alongside features that protect consumers from the cost of companies making speculative investments in network infrastructure in expectation of future demand increases that do not materialise.

However, given the scale and pace of changes expected in the energy economy, investment decisions for Net Zero will increasingly need to be taken outside of the 5-year price control setting processes, supported by an agile, adaptive regulatory framework that continues to protect existing and future consumers. In this context, the Scheme is subject to a separate set of arrangements to general network development activities being undertaken within the current RIIO-ED1 price controls. More information on the regulatory treatment of the Scheme can be found in the next section.

This Green Recovery Scheme provides a significant opportunity for the electricity distribution networks to help drive these changes and to maximise the opportunities that will enable a smarter and lower-cost zero-carbon future.

We recently set out the methodology decisions for the RIIO-ED2 price control, covering the period from 1 April 2023 to 31 March 2028.⁶ These decisions confirm our broader approach to ensuring the electricity distribution networks are prepared to power net zero and will shape the submission of DNO business plans for the 2023-28 period later this year.

We are exploring options for similar arrangements with the electricity transmission and gas sectors. However, this needs to happen in the context of their RIIO-2 price controls. The RIIO-2 price controls set out in our December 2020 Final Determinations⁷ already includes the tools and flexibility that Ofgem considers appropriate to enable the types of strategic investments envisaged under the Networks Green Recovery Scheme. This includes numerous uncertainty mechanisms, such as the system-wide Net Zero reopener, and over £600m of pre-construction allowances for companies to develop new Net Zero project proposals.

⁶ <https://www.ofgem.gov.uk/publications-and-updates/riio-ed2-sector-specific-methodology-decision>

⁷ <https://www.ofgem.gov.uk/publications-and-updates/riio-2-final-determinations-transmission-and-gas-distribution-network-companies-and-electricity-system-operator>

Regulatory treatment

We consider making low regret, strategic investment is consistent with the DNOs' current licence obligations to develop and maintain an efficient, coordinated and economic electricity system. We have committed to consider the need for any urgent licence changes, consultations, or other regulatory changes that are necessary to give effect to the Scheme.

We consider that investment made under the Scheme must comply with a set of principles set by us. These include that proposals, as far as reasonably practicable, should:

- be consistent with developing an efficient, coordinated and economical system; all available options to efficiently meet future network user needs should be considered
- fairly apportion benefits, costs and risks including vulnerable customers
- not discriminate between any person or classes of persons
- support competition in the connections market
- support competition in other markets
- be focused on addressing proven market failures
- be optimised across the whole electricity system
- be capable of implementation with minimal modification to existing regulatory arrangements
- be separate to discussions on the setting of future RIIO price controls
- be generally consistent across sectors.

In accordance with the principles and selection criteria set by us, DNO licensees will review their network development plans to identify areas where low regrets, targeted expenditure in the network would support future user needs in light of recent Government climate change ambitions. This would include, for example, consideration of the UK Government's commitment in their Ten Point Plan for a Green Industrial Revolution, and where appropriate for the distribution networks, to ensure grid capacity at Motorway Service Areas (MSAs) is prepared for EV uptake.⁸ For relevant DNOs, it would also include commitments made by the Welsh and Scottish Governments. For example, the Welsh's Government's EV Charging Strategy⁹ and the Scottish Government's Climate Change Update Plan.

Through the ENA co-ordinated Green Recovery call-for-evidence there will also be opportunities for stakeholders to shape DNOs' thinking about future users' needs. This

⁸ This is part of a wider programme to review grid capacity for MSAs, including on the electricity transmission networks

⁹ <https://gov.wales/electric-vehicle-charging-strategy>

process will be closely coordinated across the electricity network sectors to ensure whole system network optimisation opportunities are realised.

The DNOs will submit to us full details of any prioritised proposals for review prior to the initiation of any Scheme Projects. At that stage, and in consultation with Government where appropriate, we will provide commentary on the proposals to ensure consistency with the criteria and principles set, agree the reporting requirements for Scheme costs, and confirm any expenditure caps that will apply to the relevant DNO Licensee.

Any expenditure incurred under the Scheme will be met from existing RIIO-ED1 allowances. Where a DNO is currently forecasting to exceed their RIIO-ED1 allowances in aggregate over the full 8-year price control period to 31 March 2023 new funding will be permitted, subject to an agreed cap and separate regulatory arrangements. This approach will allow expenditure that might otherwise have been considered as part of the RIIO-ED2 price controls to be accelerated for earlier delivery where it is in consumers' best interests.

The values of those caps will be set by us following the call for evidence and consideration of commercial submissions when the DNOs notify us of their short-listed proposals. Expenditure exceeding current RIIO-ED1 forecast expenditure up to and including the cap will have the incentive rate set to zero. Any expenditure over the cap will not be subject to this funding mechanism and will therefore continue to have the incentive rate applied under normal RIIO-ED1 provisions.

All Schemes must be in line with the agreed principles and criteria, which provide an obligation on the DNOs to respond to the requirement in an efficient way. These criteria also provide an obligation on the DNOs to not discriminate between any persons or classes of persons.

Any expenditure incurred will be compensated in line with the agreed funding mechanism if the ex-ante agreement on the scope of liable expenditure and efficiency is followed.

This process will be subject to consideration of regulatory change, including consultation, licence change, or any wider changes required to give effect to the Scheme.

Nothing in this letter shall be construed as absolving the networks of their regulatory and statutory obligations. The DNOs must continue to comply with these obligations, including all the conditions that relate to the RIIO-ED1 price control.

Next steps

We are keen to hear any comments that stakeholders may have on our proposed regulatory treatment of the ENA Green Recovery Scheme. Please send any comments to RIIO-ED1@ofgem.gov.uk by 8 March 2021. If you would you like to shape DNOs' thinking on future users' needs, then we would encourage you to respond to the ENA Green Recovery Scheme Call for Evidence. If you have any general queries regarding the information contained within this letter, please contact RIIO-ED1@ofgem.gov.uk.

Yours faithfully,

Steve McMahon

Deputy Director, Electricity Distribution & Cross Sector Policy