

OVO group -written evidence (ONZ0001)

1. OVO

1.1. OVO Group ("OVO") welcomes the opportunity to respond to the call for evidence, and we support the Select's Committee's efforts to understand the significant changes needed to achieve Government's net zero targets.

1.2. OVO is a collection of companies (incl. Kaluza) driving progress to net zero carbon living through harnessing clean, affordable energy for everyone. Across the group, OVO serves nearly 5 million customers with intelligent energy technology solutions to decarbonise homes. Founded in 2009 by Stephen Fitzpatrick, OVO redesigned the energy experience to be fairer, greener and simpler for all. Today, OVO is on a mission through its sustainability strategy, Plan Zero, to tackle the most important issue of our time - the climate crisis. This includes our commitment to achieve net zero emissions across our operations and support our five million members in eliminating their household emissions by 2030. Kaluza is the technology partner for OVO Energy enabling the real-time billing and domestic flexibility offerings for OVO Energy.

2. Ofgem's Remit

2.1. OVO believes that in order to achieve net zero targets, Ofgem's remit needs updating to keep pace with the June 2019 legally binding commitment to reach net zero by 2050. We urge the Government to take prompt action and align the regulator's objectives with its carbon reduction targets. To ensure they drive radical thinking in the regulator, these objectives should be clear and quantifiable and not vague as the current status quo. This change would be in the best interest of 'current and future consumers', aligning it clearly with Ofgem's duties to Parliament.

2.2. Ofgem's statutory functions set out in the Gas Act 1986 ("GA") and the Electricity Act 1989 ("EA"), and statutory duties which apply to the majority of these functions, set out in sections 4AA GA and 3A EA. The principal objective of Ofgem under these sections is to protect the interests of existing and future gas and electricity consumers (the "Principal Objective"). However, this remit does not necessarily help Ofgem make difficult trade-offs between affordability now and in the future, long-term security of supply and decarbonisation. The result is that the regulator often makes policy decisions which do not align with the UK's legally binding targets.

2.3. When faced with two or more options, Ofgem does not have the power to act outside of its Principal Objective and discard an option that does not align with a

net zero scenario if this option is more cost-effective. In the hypothetical scenario where Ofgem was to choose between an option A and an option B, a simplification of the problem could be illustrated as follows:

	Impact on net zero targets	Impact on consumers
Option A	Does not align with net zero targets and acts as a barrier to the deployment of renewables	Neutral impact on consumers
Option B	Aligns with net zero scenarios and facilitates the deployment of renewables	Increase in costs for consumers

If Ofgem chooses option B, the regulator could face a legal challenge due to the negative impact on consumers.

2.4. An example of this in practice is Ofgem's Targeted Charging Review decision that harmed the deployment of embedded renewable generation.

2.5. The guiding principles for Ofgem's decisions were:

- Arrangements support efficient use and development of network capacity
- Arrangements reflect the needs of consumers as appropriate for an essential service
- Any changes are practical and proportionate, considering

No net zero considerations were formally included in the decision, apart from a side impact assessment .

2.6. The 'best interest of consumers' duty should include the broader effects of energy policy on the wellbeing of future and current consumers and not only the short-term economic impact.

For example, according to Public Health England, air pollution is the most significant environmental threat to health in the UK, with between 28,000 and 36,000 deaths a year attributed to long-term exposure. There is strong evidence that air pollution causes the development of coronary heart disease, stroke, respiratory disease, and lung cancer and exacerbates asthma.

2.7. We believe that by changing the remit to prioritise the alignment with net zero targets, Ofgem will better protect the best interest of consumers. There is no conflict of interest or material downside of taking forward the much-needed change. Critical will be setting clear “metrics for success” that consider the efficiency of the system, the cost to consumers, and the carbon implications would send clearer signals to industry and policymakers on the direction and pace of change.

2.8. Impact assessment scenarios supporting policy positions is another example of the need for urgent reform. Currently, the regulator has no obligation only to consider scenarios compatible with net-zero. Ofgem conducts impact assessments with scenarios such as a ‘steady progression’ scenario that does not align with the net-zero target.

2.9. The Steady Progression scenario is described as follows by National Grid: “While home insulation improves, there is still heavy reliance on natural gas, particularly for domestic heating. Electric vehicle take-up grows more slowly, displacing petrol and diesel vehicles for domestic use, however decarbonisation of other vehicles is slower with continued reliance on diesel for heavy goods vehicles. In 2050 this scenario still has significant annual carbon emissions, short of the 2050 net zero target in UK legislation.”

2.10. Please find below an impact assessment of the Targeted Charging Review where performance of policy measures was assessed in a ‘steady progression’ scenario.

Table 2 Overview of projected benefits of TCR residual reforms £bn, NPV of Total Cost Change, 3.5%, 2019-2040

Scenario/sensitivity	Consumer benefits	System benefits (central carbon appraisal value)	System benefits (high carbon appraisal value)
Steady Progression	0.5	1.0	1.8
Community Renewables	1.2	3.2	6.1
High Residual (based on Steady Progression)	1.6	1.0	1.9
Low Residual (based on Steady Progression)	0.5	0.8	1.3

2.11. We understand the academic thinking behind the rationale to assess policy options in this scenario. However, Parliament has rightly set a legal target to reach net-zeros and the Government is creating Sectoral Plans to decarbonise the economy rapidly over the next 30 years. The regulator is assessing policy options in scenarios that will not materialise as the Government is and will continue to take action. Actions include the Transport Decarbonisation Plan, the Ten Point Plan, and the upcoming Heat and Buildings Strategy.

2.12. With a mandate aligned with net zero targets, Ofgem will no longer need to test policy decisions on 'do nothing' scenarios. The current Principal Objective often leads to discarding policy options that perform well in the decarbonised future Government is building.

2.13. To conclude, Ofgem has demonstrated to be an efficient and transparent regulator; however, the current remit does not give Ofgem the power to make decisions aligned with the Government's net-zero targets. We urge the Government to take prompt action and amend Ofgem's remit.

3. A legal framework securing net zero long term strategy

3.1. The vague and not binding environmental duties could be sufficient when the political environment supports net-zero measures and plans. Should we see a political change or public pressure to change priorities in the future, a legal framework will ensure regulators and licensees continue to work towards net zero targets. Any disruption even for a couple of months or years in direction and strategy will jeopardize all efforts to achieve the UK legally binding commitment to achieve net zero by 2050. We therefore favour putting in place the legal framework now to accelerate action.

4. RIIO and net-zero, an example of the lack of embedded clear carbon targets

4.1. Ofgem's policies and decisions should have embedded carbon reduction targets. Embedded carbon targets will avoid the 'pass the stick' situation between different market players. All energy and gas markets participants should aim for the same objective: achieving net zero. The absence of clear targets on emissions reduction and the lack of accountability from different players results in decisions not fit for decarbonisation purposes.

4.2. An example of these inefficiencies is the flexibility markets which will be vital for the net zero transition as an increasing proportion of low-carbon power comes onto the system. Flexibility markets often do not differentiate between carbon-intensive and polluting technologies and low carbon technologies. Network system operators' IT systems 'call' flexibility assets following a merit order based on historical decisions, size of the unit and price. The IT systems or the staff qualifying and calling units do not differentiate between carbon-intensive and low carbon or renewable generations. System operators balance the intermittency of renewables with polluting generation when flexibility providers such as Kaluza provide low carbon solutions directly benefiting consumers. Embedded carbon targets in every

decision made by the regulator and the different actors would avoid these counterproductive actions that make achieving net-zero harder.

4.3. Setting price control frameworks for the gas and electricity network companies of Great Britain is one of Ofgem's most essential duties. Whilst RIIO-2 draft frameworks include environmental considerations, these are vague and not bound to Government's targets. Network companies do not have strong enough incentives to align with net-zero objectives. To achieve net zero, carbon reduction targets need to be embedded in every decision made by the regulators and all energy players, including the network companies.

4.4. Network companies need stronger, clean and quantifiable environmental objectives but Ofgem will only have the power to change the RIIO frameworks if their own remit is amended accordingly. This rationale applies to other players including other licensees such as energy suppliers, generation, interconnectors and storage.

5. **Net zero objectives for Licensees, in particular Suppliers**

5.1. Households' role in decarbonisation is critical. Homes, including heating, EVs, demand response and consumer behavioural change, will play a key role in achieving the UK's 2050 net zero targets.

5.2. Suppliers, providing the regulatory framework aligns with net zero, should be a major partner in delivering net zero due to their close relationship to the consumer and their understanding of what individuals will need to take action on decarbonisation. OVO sees the consumer as the key player to achieve net zero and we see ourselves as a decarbonisation delivery partner in the home. Our whole business is orientated around our belief that climate change is the biggest, most pressing challenge facing humankind.

5.3. We have a core strategy called 'Plan Zero' - it sets out our purpose to create a world without carbon and is central to our company culture. Since we launched our Plan zero and specific targets for our business and consumers, we have experienced a shift in the organisation culture. All our decisions are made thinking about the bigger plan: our Plan Zero. OVO has been a first-hand witness of the importance of clear measurable targets and accountability.

5.4. Most importantly, for our customers, it commits us to:

- optimising 5m homes with low carbon and flexible technologies e.g. electric heat pumps or V2G technology
- helping our members to halve their carbon footprint by 2030.

5.5. Suppliers play and will play an even more critical role in delivering net zero -

for too long the retail market has been seen as a constraint on progress, but the introduction of new technologies and services mean it could now be a driver of reducing household emissions. It can be the bridge between decarbonising the energy supplied and the home in which it is used.

5.6. The regulatory framework should move from focusing only on 'getting the cheapest price for current consumers' to 'work with suppliers to put consumers at the center of the net zero' challenge, giving fair consideration to long-term priorities like net-zero .

6. Long Term net zero focus versus short-term economic impact

6.1. Ofgem's impact assessments are often focussed on short term economic impact. Future consumers' interests are heavily discounted, and the horizon rarely covers impact on 2050.

6.2. In order to successfully support the industry as a progressive regulator, Ofgem should be clear on the direction and outcomes of large programmes of reform such as this. Setting "metrics for success" that consider the efficiency of the system, the cost to consumers, and the carbon implications would send clearer signals to industry and policymakers on the direction and pace of change. In other words, being clear about the outcomes of the change (rather focusing on the "defect to be fixed") should support longer-term and more forward-looking decision-making.

7. Security of supply

7.1. The transition to net zero requires various considerations around maintaining security of supply and can only be achieved cost effectively if customers down to household level are engaged in this energy transition. The shift to high penetration of renewable generation (wind and solar) requires fundamental change from shifting generation to meet the demand to using inherent flexibility in electricity demand to make the most of renewable electricity when it's available. If the right incentives and market designs are not put in place early this will create significant challenges to security of supply and impose additional costs to the network infrastructure and have further impacts on all consumer bills. Alternatively, creating incentives and markets that unlock demand response across the whole system (down to household level) help facilitate the net zero transition at reduced cost and lower impacts to the security of UKs energy supply. That is why OVO is investing in

our technology platform Kaluza to secure these benefits upfront and keep the system secure.

7.2. Currently, Ofgem has been sufficiently successful at managing issues relating to security of supply however the current remit does not recognise the urgency of addressing potential challenges associated with net zero future that will only materialise in the years ahead. If remit emphasis is changed to 'net zero' then further work will need to be done to ensure market readiness for net zero across various scenarios (incl. More ambitious FES 2021 examples like 'Leading the way')

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