

MCS Charitable Foundation and MCS Company - Written evidence (ONZ0008)

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MCS Charitable Foundation

Our vision is a world where everyone has access to affordable and reliable renewable energy and zero carbon technologies – for the benefit of our environment, our communities and the general public. As a Foundation we work to increase public confidence, awareness and access to renewable energy and zero carbon solutions across the UK. We support education and engagement programmes, fund research and facilitate innovative solutions to drive widespread adoption.

In addition, the Foundation oversees the [Microgeneration Certification Scheme \(MCS\)](#) which defines, maintains and improves quality standards for renewable energy at buildings scale.

MCS Company

Since 2008, MCS has been the only recognised Standard for UK products and their installation in the small-scale renewables sector. It is a mark of quality. We create and maintain standards that allows for the certification of low-carbon products and installers used to produce electricity and heat from renewable sources. We are impartial: technology neutral, manufacturer neutral, and supportive of Installers committed to quality installations and consumer protection. Membership of MCS demonstrates adherence to recognised industry standards, highlighting quality, competency and compliance. Our mission is to give people confidence in low-carbon energy technology by defining, maintaining and improving quality.

Background

The Industry and Regulators Committee is launching an inquiry into the work of Office of Gas and Electricity Markets (Ofgem), a non-ministerial government department which regulates the UK's gas and electricity markets. Having initially focused on protecting the interests of consumers, Ofgem has increasingly been given responsibilities in relation to other areas, particularly the security of the UK's energy supply and decarbonisation. In the Energy White Paper, the Government committed

to including a requirement for Ofgem to carry out its regulatory functions in a manner consistent with securing the Government's policy outcomes, including "delivering a net zero energy system while ensuring secure supplies at lowest cost for consumers", in its proposed Strategy and Policy Statement for Ofgem. This inquiry will consider Ofgem's role in the transition to net zero and whether changes are needed to its objectives and powers or its role in the wider energy system. The inquiry will also examine how net zero relates to Ofgem's other responsibilities such as affordability and the security of the UK's energy supply, how Ofgem considers the interests of consumers, and Ofgem's relationship to Government and Parliament.

Questions

1. What role should Ofgem play in the transition to net zero? What changes, if any, should be made to its remit, responsibilities and resources?

MCS believe that as energy regulator, Ofgem will play a key role in our transition to a net zero energy system and ensuring that consumers and industry understand the respective roles they will play. Going forward, Ofgem will also need to consider the broad spectrum of technologies that will play a role in delivering a net zero energy system and the move to a more decentralised system as well as local electricity supply. For example, Ofgem is to be designated as the heat networks regulator through BEIS' Heat Networks Market Framework, and potentially also for Scottish heat networks, which will broaden Ofgem's remit significantly through regulating for decarbonisation and technical standards of heat networks as well as elements such as consumer protection and pricing. Unlike traditional gas and electricity markets, there are thousands of heat networks across the UK each with different characteristics. To regulate this sector effectively, Ofgem will need to –

- Be able to adapt its approach to very large energy companies and very small community-led or landlord-led schemes.
- Have closer links into, and knowledge of, the property sector; by which, many heat networks are owned.
- Have the resourcing and expertise to regulate in new areas; including potentially decarbonisation and technical standards.
- For heat pumps which may be part of larger scale heat Networks or local electricity providers using smaller scale renewable technology we would advocate discussion between Ofgem and MCS on standards of equipment approved and installation standards

that should be advocated and considered as part of this future responsibility and remit to make sure that applications for smaller scale generation conform to appropriate standards to protect consumers and should work closely with MCS.

- To review the environmental levy placed on electricity tariffs and develop a fair and equitable transfer of levies over a period of time on to more carbon intensive fuels to encourage home owners to transition and to reduce electricity costs to consumers.
- Ofgem also needs to examine the future of the gas grid as more and more people switch to domestic renewables and electrification of heat that network management of gas supply grids will become economically less viable. It is vital that those charges are not passed on to the electrification market.
- Hydrogen will also become an energy source within 20 years, mainly for industrial decarbonisation and supply networks and grids will have to be managed.
- Ofgem should also take on responsibility for any Carbon Capture and transport networks and the associated management.

2. How well does Ofgem balance environmental objectives against its responsibilities in relation to affordability for consumers?

Until the publication of Ofgem's Decarbonisation Action Plan in early 2020, Ofgem did not have clear objectives on climate or decarbonisation. In assessing Ofgem's ability to balance these objectives now, it is important to distinguish the different roles Ofgem plays across energy policy.

In some cases, Ofgem's role is highly administrative and is wholly reliant on BEIS setting policy.

For example, Ofgem has very little influence on energy efficiency improvements and associated consumer behaviour/awareness, acting only as administrator for schemes such as the Energy Company Obligation (ECO) and Warm Homes Discount.

In other areas, however, Ofgem has a stronger role to play. This is particularly important in the significant policy development and decision-making it holds in the regulation and incentives for the network operators, including the Electricity System Operator, in designing the overall framework for network charging and in future, possibly in guiding the strategic direction of codes and standards changes as well as reducing the cost of electricity to consumers.

Finally, Ofgem's role is likely to grow in future – towards regulating heat

Networks, hydrogen and local electricity generation dealing with local and small-scale suppliers and will become more decentralised. The regulatory regime being designed by BEIS needs to include provision to regulate for decarbonisation as well as comprehensive detail on consumer protection and redress. It also needs to consider charges based on the CO₂ generation level of the energy within its remit. Government strategy is to decarbonise and achieve Net Zero and Ofgem has to be monitored on progress against these targets and moving towards a zero carbon energy network by 2050, phasing out all low carbon technologies and energy systems.

MCS considers that in those areas where Ofgem has significant decision-making power, Ofgem is mindful of the need to protect future consumers which is part of its statutory duty and includes consideration of the carbon impact of its decisions within impact assessments. There are real issues around fuel poverty and Ofgem needs a stronger remit in helping to not only tackle these issues through pricing and tariffs but also needs to provide stronger remits to energy companies to tackle energy efficiency measures and heating sources to bring people out of fuel poverty. This will need Government support and advice and would recommend that Ofgem has a direct remit in tackling fuel poverty.

Firstly, Ofgem is often reliant on Government policy and is hesitant about over-stepping its statutory duties – for example, in providing greater revenue to renewable technologies as a proxy for subsidy support. This is appropriate but can create frustration and a sense that Ofgem is not working to progress decarbonisation.

Secondly, Ofgem often models renewable electricity capacity deployment as exogenous in its modelling by taking the rate of deployment of onshore wind, offshore wind etc. within the Future Energy Scenarios or equivalent as an input to the modelling, rather than as an output and modelling the impact on deployment resulting from their decisions. Whilst the modelling does show revenue declines for such capacity which indicates a negative impact on decarbonisation, this means that the headline figures that Ofgem presents on the carbon impact of their decision-making are often quite artificial.

Thirdly, over the last few years, there has been a lack of strategic direction and willingness to set out a vision for the future that has contributed to a lack of focus and urgency in Ofgem's policymaking to enable a decarbonised energy system. This is clearest in the price controls and network charging reforms which do not seem to have a clear vision in mind of what is needed by the end of the 2020s and have therefore, struggled to prioritise the most impactful reforms for flexibility. This needs to become a priority as old existing models will need to change to reflect the rapid transition towards electrification and the decline of the gas grid

over time. With and emerging technologies like Green Hydrogen there needs to be a clear transition period and external review of Ofgem and how it will help facilitate Net Zero rather than maintain the status quo.

3. How well does Ofgem fulfil its obligations to consumers? Does Ofgem take consumer views into account sufficiently, particularly those of vulnerable consumers?

MCS does not have a view on this question.

4. What implications will the transition to net zero have for the security of the UK's energy supply? How does Ofgem currently manage issues relating to security of supply?

The transition to net zero will fundamentally change how we ensure security of supply. Regardless of whether heat decarbonisation is mainly electricity or supplemented by other technologies, there will be a far greater role for flexibility to ensure second by second as well as intraday and day-ahead balancing of electricity supply and demand. Ofgem has a very significant role to play in the development of flexibility in across the UK because it regulates the ESO and DNOs who are the major procurers of flexibility currently, it regulates the retail market where domestic flexibility is likely to become increasingly important and it designs the network charging framework that is also likely to provide strong signals for domestic and non-domestic flexibility.

Thus far, Ofgem has supported flexibility at a strategic level, but this has not translated into sufficient progress at a policy level. They have made good progress in requiring the DNOs to commit to procuring flexibility if it is more cost-effective than network reinforcement and beginning to develop flexibility markets at distribution. However, as stated below for question 5, this has been relatively slow. Further, their network charging reforms have failed thus far to produce significant progress in providing greater value for flexibility and have lacked a clear link between Ofgem's strategic direction and detailed policy development. With recent increases to household bills there needs to be a way of finding Net Zero cost effective solutions through the transition, with a focus on the end goal of zero carbon energy sources that are secure and the nuclear generation can fill those gaps.

5. Is Ofgem's current system of price controls appropriate? Does it provide sufficient incentives to invest in the context of the transition to net zero?

Traditionally, the price control has been designed so that, put simply, if the network operators are able to beat a cost baseline for a given volume of reinforcement, they would earn additional revenue. Ofgem is already starting to evolve this in response to the need for greater use of flexibility markets to support a decarbonised energy system. They have very fundamentally changed the ESO's price control since its legal separation from National Grid and are pushing the Energy Network Association and the individual DNOs to embed this into their business plans for RIIO-ED2.

Whilst this is positive, there are more complex and significant decisions to be made in the next few years as to whether this model will be sustainable into the late 2020s and in particular, regarding –

- The appropriate regulatory framework for asset-light system operations at distribution. Currently, the DNOs are developing system operation functions alongside their traditional regulated asset base. The latter preserves their very strong creditworthiness and drives their appetite for risk and return on capital. As we are now finding with the ESO, removing this regulated asset base and placing the entire focus on systems operations creates a very different organisational risk profile and cost of capital. Whilst it is still too early to draw clear conclusions from the ESO's new price control, it does already suggest that if the DNOs are to continue to develop system operation functions into RIIO-ED3 (rather than it being taken on by another actor), it may require a fundamentally different price control structure.
- Whilst Ofgem has emphasised the importance of a whole system approach through RIIO-2 across the network operators and system operator, this is relatively superficial thus far. For example, it is very difficult for cost savings made by one network operator as a result of additional costs being incurred by another to be transferred even if it is the most cost-effective approach for the system as a whole (for example, a DNO using its assets to reduce reinforcement needs for NGET).
- The last price control was eight years ago. Whilst this one will only be 5 years and there are several mechanisms within the price control to respond to unexpected changes in the market or in policy (including the wide-ranging net zero re-opener), there is still significant risk that the price control significantly constrains Ofgem and the network operators' ability to move quickly to invest towards net zero. This has been seen in the most recent price control where useful interventions were not understood at the time and no provision was made for them; for example, flexibility markets. As a result, Ofgem and the network operators have arguably had to rely

too much on innovation funding and trials rather than moving quickly to embed it into business as usual.

6. Is the current system of governance for the UK energy market appropriate to secure the transition to zero? What improvements could be made and what role should Ofgem play?

The current system of governance is likely not appropriate for the transition to net zero.

Whilst relying on industry self-governance ensures access to very strong expertise in the detailed policy being reformed and an important route for industry to be part of developing proposals, it has several drawbacks in an energy system transitioning to thousands of actors and new business models.

This is because the current system relies upon industry resourcing intensive and often lengthy working groups to propose and develop modifications. This requires companies to have sufficient staff resource to dedicate to changes and leads to change being made incrementally. Whilst there are powers, such as Ofgem's Significant Code Review mechanism, to impose a more strategic and holistic change to codes and standards, they are relatively limited at present.

MCS cautiously supports BEIS and Ofgem's proposals for very significant reform away from industry self-governance. However, we would note that these changes, as currently proposed, are likely to give very significant additional powers to Ofgem in providing and enforcing the strategic direction of changes to the energy system's codes and standards. This will only increase the need for Ofgem to be able to translate high-level strategy into detailed policy.

7. Are Ofgem's duties and powers appropriate and sufficiently clearly defined? Do Ofgem's objectives conflict and, if so, how should any conflicts be managed?

Thus far, Ofgem's duty to future consumers is useful in prompting a focus on decarbonisation. But could do with more clarity and targets.

8. Is Ofgem's relationship to Government and Parliament appropriate? Are there issues related to the split of responsibilities, transparency or accountability

Ofgem is and should be independent of Government and Parliament. On a more day to day perspective, the relationship between Government and

Ofgem is clearly at times difficult which can sometimes lead to attempts to shift blame on both sides.

MCS is sympathetic to the view that the split of responsibilities would be clearer on the bigger issues that Ofgem plays a role in if BEIS were to provide a clearer, strategic view on certain issues. This is the case, for example, with volatile network charging signals. Such signals would reveal the value of flexibility and could be used by users and those acting on their behalf to optimise their heating and EV smart charging to earn revenue and support electricity system operations. However, Ofgem is hesitant about developing this because of the impact on domestic customers and is therefore, looking at mitigating actions within the network charging framework itself. In this instance, a more reasonable division of responsibilities would be for Ofgem to create a framework that allows network charging to be volatile and then, for BEIS to support this by putting in place appropriate consumer protections.

9. How does Ofgem compare to similar bodies internationally? What lessons can be drawn from the experience of other countries or jurisdictions?

MCS does not have a view on this question.

10. Are there any other aspects of Ofgem's work that the Committee should consider?

With an increasing remit, Ofgem needs to ensure that it does not lose sight of its initial objective of protecting the interests of consumers in a market that is likely to be dominated by electricity consumption.

The Energy white paper makes several references to fairness and affordability for consumers, protection of the fuel poor and the opportunities for consumers to make savings on energy bills. The transition from fossil fueled heating (and transportation) to electricity driven systems will have an adverse effect on consumers under current energy pricing structures which favour fossil fueled heating systems in particular.

The current price differentials between mains gas and electricity could limit the uptake of heat pump technologies and hence the potential benefits of reductions in energy consumption, CO₂ emissions and consumers energy bills. Electricity costs per kWh are typically four times that of natural gas, this price differential eliminates the consumer benefit, from a financial perspective, of the potential 3-4 times reduction in

energy usage associated with heat pump-based heating systems. Heating a home via a heat pump, where natural gas heating is available, is likely to cost a consumer more under the current pricing structure.

Whilst smart metering and time of day pricing may enable cost reductions for those consumers who can shift their usage patterns (due to lifestyle, presence of battery storage etc), other more vulnerable groups of society may not be able to do so and hence may incur additional heating costs.

Similarly, as electrical energy demand rises with the greater adoption of electricity consuming devices (such as EV's and smart appliances), the flexibility of supply vs demand pricing may reduce.

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