

## **Cadent Gas Limited- Written Evidence (ONZ0019)**

I am writing on behalf of Cadent in response to the Industry and Regulators Committee's Call for Evidence relating to their Inquiry into the work of Ofgem.

Cadent owns and operates four of the eight gas distribution networks in the UK. Our pipes carry gas to 11 million homes, schools, hospitals and businesses in the North West of England, the West Midlands, the East of England and North London. As an organisation at the centre of the UK's energy transition we welcome the inquiry into Ofgem's role and how it can best support meeting Net Zero. I have set out below a summary of our views on Ofgem's role, the outcomes it should target and the methods it utilises, and have included a more detailed annex responding to the specific questions posed in the Call for Evidence.

Cadent is firmly committed to playing our part in the UK's transition to Net Zero by 2050 and is leading the way in developing the green gas and hydrogen infrastructure we will need in order to get there. We are also actively contributing to the debate on how to achieve Net Zero and recently published our *Green Print – Future Heat for Everyone* report, which goes beyond current thinking on the *economic* and *technical* aspects typically covered, and argues for the need to place *consumers* properly at the centre of the debate.

### **The role of Ofgem in supporting the transition to Net Zero**

Ofgem will of course play a pivotal role in the transition to Net Zero as the energy sector's economic regulator. Delivering the transition successfully will, however, require several major challenges to be overcome, including:



- supporting the *consumer* in the transition – by aiding the affordability of the transition in an equitable way and ensuring it minimises disruption;
- proving the *technical* pathway to Net Zero – by keeping options open to resolve uncertainties and ensuring gas and electricity solutions are each given proper consideration (particularly to decarbonise heating – which will be extremely difficult); and
- ensuring robust *economic* decisions are made – by promoting whole systems thinking to incentivise investment to come forward at the right time to deliver a Net Zero energy system.

We believe that serious consideration needs to be given to these issues and whether changes are required to how the sector operates, to ensure decisions made are co-ordinated, consistent and effective in addressing them. These changes could involve alterations to the institutional framework. For example, in our Green Print, we asked whether there is a need for a new body to ensure we do not plan in silos and deliver a patchwork of 'easy' solutions without considering the impact on the whole system or of harder areas. Alternatively, they could also involve refining Ofgem's duties or use of Strategy and Policy Statements by Government to guide developments. Whatever the precise mechanism used though, what is important is for the sector to 'function as one' to deliver the required outcomes to support the transition (see below).

Regardless of any changes made, Ofgem will still have a critical role to play in creating the framework and incentives; and the development of rules, codes and responsibilities to 'bridge the gap' between Government policy (as led by BEIS), and these outcomes.

### **The outcomes Ofgem should be targeting to support the energy transition**

Historically Ofgem has been primarily focussed on ensuring the affordability of energy services and good customer service, while also ensuring the 'productive efficiency' and the financeability of network companies. To deliver a successful energy transition, however, the outcomes Ofgem are seeking to deliver will need to evolve for:

- *Consumers* – in achieving an affordable and fair transition that meets their diverse needs;
- *Investors* – so that they can be incentivised to provide the finance for projects to manage and resolve uncertainties with the transition pathway; and



- *Industry* – so that the integration of electricity and gas can be managed, and so networks and network companies can transition themselves to play the roles they need to in a Net Zero energy system that delivers solutions across the heat, transport and power sectors.

### **The tools Ofgem uses to influence the market to deliver required outcomes**

Ofgem has successfully employed the RPI-X price control framework, and its successor, RIIIO to deliver energy affordability, improvements in customer service, productive efficiency and financeability of network companies. For example, energy network costs have fallen significantly leading to lower consumer bills and, with the introduction of RIIIO, consumer service quality and customer satisfaction scores across sectors have consistently improved.

Notwithstanding this success, to transition to a Net Zero economy, and fulfil the outcomes set out above, these frameworks will now need to change as the conditions that have brought about their success, are unlikely to hold going forward:

- outputs to deliver the Net Zero transition are far less clear than those that networks have needed to deliver over the past two-three decades;
- reasonable forecasts of costs and demand are difficult to make given uncertainties over required investments to deliver the transition;
- where uncertainties are present, the high relative proportion of re-openers to automatic adjustment mechanisms, mean companies lack sufficient understanding of how their activities could change as uncertainties are resolved; and
- there is a lack of certainty that efficiently incurred investments will be recovered and earn an adequate rate of return.

### **Key priorities for supporting the energy transition**

In our view there are several key priorities where change is required to support a successful energy transition. These relate to both Ofgem's role and how Ofgem operates the regulatory framework:

- *supporting the development of both electricity and green gas* – the path to Net Zero is uncertain and consumers will want to see different options for their energy needs. It is key that options are kept open and advances made for hydrogen, as well as electrification. To support this it is important that Ofgem give proper weight to electrification and green gas



- options - and consider aligning the structure, assumptions and outcomes sought in evolving network price controls.
- *developing a clear, affordable and equitable proposition for paying for the transition* – consumers, will ultimately pay for the energy transition. Therefore, urgent thinking on how to align benefits of decarbonisation to how costs are recovered are needed. This will also include considering effects over time and across consumers to develop charging approaches to establish how to equitably and affordably share the costs of the transition.
  - *building on what works, but adapting the framework to bring forward investment needed to unlock the transition* – there are elements of RIIO (such as incentives on customer service) that really drive behaviours and are important to maintain. However, to ensure changes happen at pace, it is important to consider whether the ‘adaptive price control’ process adopted by Ofgem will be sufficient. For example, simplification of the framework for Net Zero investments perhaps via more of a so-called ‘rate of return’ type of approach may be an effective supplement to provide agility to companies, reduce regulatory burden and enable quicker delivery.
  - *developing a new hydrogen market* – gas networks need to be re-purposed for hydrogen. This will mean wholesale changes to the gas system of today and is likely to involve establishing how roles and responsibilities are managed such as: System Operation, the interfaces between networks and revised industry codes. A cross-industry project to develop these foundations could be an important first step in doing so.

Further details on our views in relation to the Committee’s specific questions are set out in the included Annex. We would be more than happy to discuss any of our responses or the general views we have set out above.

## **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?**

- 1.1. Ofgem’s role, conveyed by its governing body, the Gas and Electricity Markets Authority (GEMA) and as originally codified in the Gas Act: 1986, Electricity Act 1989 and as amended by the Utilities Act 2000, was to ensure that energy is affordable to customers, that they receive good



quality service, and to ensure network companies are efficient and financeable. Over time though, this role has expanded to include: the protection of consumers today and in future more generally, to reduce carbon emissions from energy use, to ensure security of supply, to promote competition (where it is in consumer interests), and to have regard to best regulatory practice across sectors.

1.2. Ofgem could continue to play a key role supporting the UK's energy transition. However, we think that it is important to review this to ensure that it is proportionate to resolving challenges it has sufficient remit and capabilities to do so effectively. Therefore, we believe Ofgem's role should be distinct from:

- i. *Policy* – which should continue to be set by National and Local Government to balance the needs of the UK as a whole and different areas within it. However, there needs to be coordination between local energy plans and the whole system solutions brought forward to deliver them so that there is no planning in silos. This may require new institutional arrangements or entities being created (such as a 'Regional Net Zero Development Agency'), but Ofgem also needs to support this through supporting the resolution of uncertainties. For example, by bringing forward investments to leave options open for different energy solutions to serve different areas.
- ii. *System Operation* – there is need for urgent action to determine operating structures and requirements for gas networks to transition so that they are able to support hydrogen. This also includes understanding how new hydrogen networks integrate with the wider energy system to ensure the best whole-system outcomes are achieved. However, to fulfil such a role will require Ofgem building significant whole-system operational knowledge, both across electricity and gas – the latter of which is more limited today.

1.3. Within a continued role as the energy sector's economic regulator, Ofgem's role should follow its existing powers and duties, but evolve to ensure it supports the delivery of the outcomes needed to deliver on Government policies and consumer needs for the transition. In particular to:

- i. *support consumers in the transition*– this will require taking a long-term view on how the costs of



the transition are managed across customers (today and in future) alongside BEIS to appropriately 'share the burden' and to not create or extend any existing fuel inequalities. It will also require implementing frameworks and incentives that are technologically agnostic to bring forward alternative solutions across electricity and gas in key sectors such as heat and transport.

- ii. *ensure robust economic decisions are made to bring forward the type and level of investment needed to deliver the transition* – by adapting regulatory frameworks to incentivise the development of hydrogen and green gas and to ensure that potential decommissioning can be managed.

*prove the technical pathway to Net Zero by supporting networks and network companies transition themselves to deliver Net Zero* – recognising the different roles companies and networks must play in operating traditional networks until a transition can be made and integrating themselves into a joined-up energy system across electricity and gas. Key to this will be ensuring a consistent approach and focus to encourage the development of the best whole-system approaches to meet Net Zero and to not distort decision-making in favour of one over the other. Action on this for gas networks must be taken now to ensure that options for the pathway to Net Zero are not closed off and solutions arrived at no

- iii. t 'by default'.

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

2.1. To date Ofgem has balanced responsibilities reasonably between its environmental objectives and customer affordability. Ofgem's RIIO framework contains environmental outputs (such as business carbon footprint targets and measures to reduce shrinkage and leakage for gas companies), financial and reputational incentives and takes account of environmental impacts within cost:benefit analyses.



2.2. There are trade-offs between environmental impacts and customer service. For example, with Repex investments, customer disruption and costs can be reduced by greater insertion of existing mains with new smaller diameter Polyethylene pipes. However, this may lead to pressure increases which lead to greater emissions. Ofgem seeks to balance this trade-off through incentives on both costs and environmental impacts, but more work is needed to review and develop the appropriate environmental incentives to really drive behaviours to support affordable long-term costs to deliver Net Zero.

2.3. More recently, there has been a decrease in the value and scope of environmental incentives as Ofgem have transitioned from RII01 to RII02. Furthermore, the outputs and incentives that are present are predominantly based on controlling the environmental impact of network companies and, in gas, shrinkage, rather than what enters, passes through and exits the network (or the network is capable of taking).

2.4. With the need to make the transition to Net Zero, we believe Ofgem needs to build on mechanisms embedded in RII02 and extend its thinking on how to balance customer affordability and its broader environmental objectives by taking a longer-term and extended view beyond business operation today. In particular, considering:

- i. establishing a set of longer-term environmental requirements/targets for network companies to deliver to support the transition to Net Zero through their planning and internal choice of investment activities to undertake;
- ii. incentivising a significant amount of investment to be delivered in quick timeframes to resolve uncertainties over the pathway to Net Zero so that it is delivered at an acceptable cost. At present there appears to be some imbalance across sectors with electricity Distribution Network Operators (DNOs) seeking large base cost allowances from Ofgem to fund network reinforcement and load investment, while gas operators have only been allowed to undertake some similar works/projects on the basis of reopeners.
- iii. developing a clear proposition for how the delivery of these environmental objectives translates into energy user charges, balancing affordability for consumers today (particularly to protect those in



fuel poverty) and those in the future (to ensure the burden is shared appropriately generationally). Furthermore, in revising charging approaches, Ofgem also needs to have regard to Government policy determinations which affect gas and electricity consumers differently (for example in relation to any potential subsidies or other incentives in place to support adoption of particular low carbon technologies such as heat pumps).

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

- 3.1. Ofgem's RIIO framework encourages organisations to focus their activities on customer service outcomes, (including vulnerable customers) with a series of outputs designed to measure how well organisations deliver for customers on the outcomes they want. These include measures that focus on domestic customers and relate to levels of customer satisfaction (known as C-sat) and complaints handling. Similar measures could be developed in future for other types of customers (e.g. business customers).
- 3.2. Over the RIIO1 period Ofgem incentivised the outputs of C-sat (the higher the scores, the greater the financial reward received by organisations) and specified an additional stakeholder engagement incentive in the framework. The latter rewarding organisations for engaging with customers, stakeholders, and others to establish processes and initiatives to drive social value. As noted in our covering letter, historically over the RIIO1 period, levels of customer satisfaction in general have improved significantly, providing evidence that Ofgem's role in developing frameworks and incentives to better customer service have been positive.
- 3.3. With the recent RIIO2 final determinations for gas distribution companies (GDNs) there is the question about whether this success will persist. For instance, while Ofgem encouraged organisations to undertake an enhanced engagement programme to understand customer preferences and build a plan representing those views, there is little evidence that the findings from this process materially influenced their decision making. For example: Cadent proposed over 20 bespoke customer outcomes based



on feedback from our customers, of which only one was implemented by Ofgem. Most relevant to supporting customers in reference to Net Zero was our proposal of a 'whole-system thinking' stakeholder incentive to encourage and reward joined-up plans across the energy system to establish what good looks like across electricity and gas. Not allowing such an incentive has shown itself to have been a missed opportunity in our view as the recently issued draft DNO plans for the RIIO-ED2 price control appear to lack real evidence of whole-system thinking.

#### **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?**

4.1. Climate change and the Net Zero transition will both serve to increase customer demand for energy and significant focus needs to be given to ensuring the appropriate amount of energy is available to balance the market. Key to this will be:

- i. ensuring joined-up planning between sources (gas and electricity) and across regions, focussed on meeting peak demand; and
- ii. adopting a resilient transition pathway where electricity and green gases, such as hydrogen, each play a role.

These are each explained in further detail below.

4.2. Climate change and the Net Zero transition will increase demands on the energy system, but will also see an ever-closer integration of electricity and gas in key sectors, such as power, transport and heat. For example, and as set out in BEIS's recently released Hydrogen Strategy, the development of hydrogen will be used both in part through the gas network to satisfy heat demand but also to help balance intermittent renewables in the power sector. Renewables will provide homes with low carbon power but may also be used to produce low carbon hydrogen for use in heating homes, perhaps at times of excess electricity generation.

4.3. The planning horizons and approaches for balancing respective sources of energy currently differ right now, however. As such, there needs to be more joined-up whole system decision-making and planning to manage energy needs. Furthermore, this planning should also be aligned



across regions (where demands for electricity and gas will differ according to the solutions adopted) and be focussed on meeting whole-system peak demand, rather than average. The latter point being particularly important in heat, where there is a larger peak-average variance in demand that electricity historically has not had to meet, and which it will need to if it takes on a larger role in the sector. An alignment between gas and electricity to fulfil demand will be needed. This itself also has other implications for energy storage and the optimal mix of electricity and gas used to meet demand.

4.4. To manage joined-up decision-making across electricity and gas may also require interventions to alter the current industry structure. At the moment each source of energy is separately managed. However, more joined up decision-making will need new mechanisms to deliver it. These could include the creation of new responsibilities, codes or requirements for specific parties across electricity and gas to deliver on common whole-system energy management and security objectives. Or, alternatively, the joined-up decision-making could be achieved through creation of new bodies to manage the interface between the electricity and gas.

4.5. In addition to joining up planning between electricity and gas, a longer-term implication of Net Zero for ensuring security of energy supply relates to the pathway chosen to meet Net Zero. In particular, emphasis until recently given to the expansion and reinforcement of electricity networks over hydrogen and other green gas development. Should this continue the UK would lose resilience in its energy supply by being dependent on ensuring electricity supply is sufficient to meet consumer demands which could increase longer-term costs to consumers. To mitigate these risks, in line with BEIS's recently release Hydrogen Strategy, it is important that timely investment decisions are made to advance development of hydrogen and green gases to ensure, particularly for sectors such as transport and heat, that a variety of sources are available.

**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?**



5.1. Within its role of addressing the economic challenges of the energy transition, it is important Ofgem clearly defines the outcomes it is looking to deliver by supporting the market. To date, Ofgem has been primarily focussed on ensuring affordability of energy and good customer service for consumers while ensuring productive efficiency and financeability of network companies. However, to deliver a successful transition the outcomes Ofgem targets should be refined so that it is clear they must deliver for:

- i. *Consumers* – in achieving an affordable and fair transition that meets their diverse needs;
- ii. *Investors* – so that they can be incentivised to provide the finance for projects to manage and resolve uncertainties with the transition pathway; and
- iii. *Industry* – so that the integration of electricity and gas can be managed, and so networks and network companies can transition themselves to play the roles they need to in a Net Zero energy system that delivers solutions across the heat, transport and power sectors.

5.2. Historically, both of Ofgem’s overarching frameworks for price controls, known as RIIO, and its precursor RPI-X have had strong success in delivering affordable energy and good customer service, while also ensuring the productive efficiency and financeability of network companies. However, these frameworks are unlikely to continue to be sufficient as the conditions that have brought about their success are unlikely to hold going forward:

- i. outputs to deliver the Net Zero transition are far less clear than those that networks have needed to deliver over the past two-three decades;
- ii. reasonable forecasts of costs and demand are difficult to make given uncertainties over required investments to deliver the transition;
- iii. where uncertainties are present, the high relative proportion of re-openers to automatic adjustment mechanisms, mean companies lack sufficient understanding of how their activities could change as uncertainties are resolved; and
- iv. there is a lack of certainty that efficiently incurred investments will be recovered and earn an adequate rate of return.

5.3. In addition to the overarching RIIO framework, going forward the integration of electricity and gas sectors means that the approach to how Ofgem’s controls for DNOs and GDNs are undertaken is unlikely to be appropriate. In



particular, to deliver Net Zero will require joined-up whole-system decision-making on the best pathways to follow. However, as the structure, assumptions outcomes and evolution of price controls are not aligned, this has the potential to distort decision-making, close options off and lead to 'solutions by default'.

5.4. It is also unlikely that Ofgem's current system of controls will be sufficient to incentivise the level of investment needed to come forward to deliver the Net Zero transition on a number of counts. For example, as:

- i. the controls are designed for businesses operating in 'steady state' as opposed to those needing to make a big transition in how they operate – network companies today need to both run the network in steady state but also invest and develop future energy pathways so that they can transition to Net Zero;
- ii. uncertainty mechanisms, particularly re-openers are overly relied upon to adapt price controls but do not provide sufficient clarity over returns to incentivise investments as there once was. Furthermore, the use of re-openers creates a series of 'mini price controls' within control periods, and risks making adjustments to plans and allowances complex, slow to implement and resource intensive; and
- iii. there is lack of certainty over whether efficiently incurred investments will be able to be recovered (as set out above) – under both a decommissioning scenario (in respect of current network assets) or one using hydrogen (in respect of new assets) there is the potential for assets to become stranded as there is no guarantee costs may be recovered.

5.5. To incentivise the required scale of investment to come forward to deliver the Net Zero, RIIO should be built on going forward with potential considerations including:

- i. 'segmenting' price controls – building on aspects of RIIO that are successful and will continue to be important (such as incentives on customer service) for running the network in 'steady state', while building on this to allow for change at pace. This could include considering whether 'adaptive' regulation through use of price controls and re-openers could be supplemented for Net Zero investments with a so-called 'rate of return' type of approach to provide agility and reduce regulatory burden. Alternatively it may involve greater use of automatic adjustment mechanisms or through



- providing greater clarity on how re-openers set out may impact company returns; and
- ii. setting out clear approaches to be adopted to ensure cost recovery in the face of asset stranding – for example, either through re-affirming guarantees on regulated asset values or adopting different approaches for depreciation of stranded assets

**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?**

6.1. As outlined above, and reaffirmed in the recently released Hydrogen Strategy, green gas, particularly hydrogen, has a vital role to play in supporting the UK meeting Net Zero and doing so in an affordable and secure way. To date though, much of the policy focus and funding has been around how to meet our climate challenges with electricity centred solutions. This focus on electricity has meant comparatively little emphasis given to how we will meet the challenges of a fully electrified system, for example ensuring safe and reliable sources of heat during severe periods of cold weather or during spells of low renewable power output.

6.2. Given that the pathway to renewable heat is perhaps the most difficult and complex of challenges to overcome if we are to meet Net Zero, it is key that there is a clear pathway for investment and development of hydrogen. We have welcomed BEIS and Ofgem’s funding of several key projects to support hydrogen’s development, and the Hydrogen Strategy, but more ambition is required so that it can play its role in the decarbonisation of heat.

6.3. Ofgem as economic regulator is charged with taking a long-term view and implementing overarching Government priorities and, as such, the publishing of the Government’s Heat and Buildings strategy is keenly anticipated to sit alongside the Hydrogen Strategy. However, to ensure each strategy is implemented in a timely and efficient way will require Ofgem and BEIS to work closely together to ensure the appropriate frameworks and incentives are created to do so. This could take the form of collaborative joint working groups to address particular challenges or to lead particular projects. Alternatively it could be more ‘command’ orientated involving codifying policy change through amendments to Ofgem’s duties and powers or through use of a Strategy and Policy Statement (SPS).



6.4. In addition to closer integration of policy and implementation by BEIS and Ofgem it will also be key that national strategies are also aligned with regional energy plans and the diverse preferences for solutions across different regions of the UK. As set out in our response to Question 1 a new Regional Net Zero Development agency, or other body could support in making this happen. Furthermore, to implement overarching national and regional strategies effectively will also require Government, regulators and other bodies to ensure they have the right mix of skills and resources to meet the opportunities that hydrogen presents with the necessary pace and support.

6.5. More broadly, to further enable the adoption of green gas solutions to support the transition will also require fundamental additions to the governance framework within energy today. These changes need to be bold and represent the revolution of the energy system into one designed to deliver Net Zero. For example, new structures and governance will need to be put in place to develop the new hydrogen market including setting out how it interfaces with the rest of the energy system are managed and how the gas system of today can transition to a hydrogen network. In this regard, the boldness of the recently announced Code Governance Review from BEIS is encouraging as it shows the Government recognise that significant change is required, and we welcome further consultations to support the developments of future governance framework necessary to deliver Net Zero.

## **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?**

7.1. Ofgem's role and powers are conveyed to it by GEMA. In turn, GEMA's duties and powers are prescribed within the Gas Act 1986, Electricity Act 1989 and a range of subsequent wider legislation. These duties and powers were originally focussed on ensuring affordability of energy and quality of service for customers, while ensuring network companies are productively efficient and financeable. However, they have since broadened to also include:

- i. protecting the interests of consumers, current and future, more generally. This includes in relation to reducing carbon emissions from energy use and in ensuring security of supply and having regard to those who are vulnerable or fuel poor);



- ii. to promote competition wherever possible as long as it is in the interest of consumers;
- iii. having regard to the interests best regulatory practice across sectors.

7.2. These duties and powers are reasonably well defined and continue to be relevant and appropriate to support meeting the Net Zero transition. However, going forward there may be cause to refine them so that they reinforce delivery of the outcomes that need to be delivered in line with the strategic intent of Government and the needs of UK consumers (as discussed above in the response the Question 5).

Alternatively changes to the institutional framework of the sector or use of a SPS (as highlighted at several points above) may also be appropriate.

7.3. There may also be increased tension and potential conflict between some of Ofgem's objectives which will need to be resolved in order to deliver Net Zero successfully. The most paramount of these is likely to be ensuring affordable energy for customers, today and future, and in bringing forward the scale of investment needed to deliver the transition to Net Zero. This is particularly evident today given the level of technology and policy uncertainty over the future path to Net Zero. This uncertainty means that it is difficult for Ofgem to green light investment options necessary to deliver the transition. This in turn could mean necessary investments being delayed or scaled back where caution is applied.

7.4. This is a difficult tension for Ofgem to manage, although a key one for it to resolve. As part of doing so it should be rewarded for being bold and encouraging investments in such a way that they resolve uncertainties as soon as possible so that Net Zero can be met in the most affordable way for future consumers. Furthermore, lessons should be learnt from where similar tensions have been experienced before, for example, in relation to affordability and safety. Here, Ofgem has been able to strike a successful balance through an independent body (the HSE) setting requirements that it optimises around to secure them in the most affordable manner. In the case of securing Net Zero, National and Local Government could play a similar role determining policy to a greater level of detail than currently established to resolve uncertainties and support Ofgem in bringing forward investments.

7.5. A further tension that could also emerge in seeking to deliver Net Zero is how the development of the pathway to achieve it is balanced with protecting the interests of both



gas and electricity customers. In particular, Ofgem should be seeking to deliver an end-state Net Zero economy that is affordable, with costs shared between different customers in a fair way. As such, in line with the Hydrogen Strategy, it is important that Ofgem encourages the development of hydrogen and green gas alternatives in addition to increased electrification

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

- 8.1. Independent regulation in the UK has been a key enabler of the success of privatised industries since the 1980's as independent economic regulators are able to objectively implement and balance policy from the Government of the day with longer-term views of industry requirements. This separation remains appropriate today and is likely to also be to deliver the transition of the UK economy to Net Zero.
- 8.2. This said, as set out above in our response to Question 6, there needs to be an appropriate joining-up of Ofgem and BEIS such that key policies in relation to heat and hydrogen can be implemented in a timely, efficient and effective way. For instance, to not delay necessary investments and to ensure the transition is delivered at acceptable cost to consumers today and in future.
- 8.3. There also needs to be an appropriate balance struck between the Government, as policymaker, and Ofgem, as regulator, to manage bringing forward policy and investment forward at pace while protecting consumers. At present, there are instances where the imperative to push forward to deliver hydrogen and the energy transition under the direction of BEIS is not implemented by Ofgem as effectively as it could be. For example, on some key hydrogen projects like HyNet North West, BEIS have set out to look to progress at speed in line with the broader aims contained in their Hydrogen Strategy. However, when recognising these projects in network price controls, Ofgem has required network company contributions for funding. This is in contrast to previous projects undertaken to support some renewable electricity projects, such as subsea cables from Shetland to the mainland of the UK, where funding was granted with less or no contributions.
- 8.4. Given this, we think that, while the independence of Ofgem is appropriate, more needs to be done to align their approach to implementing policies set down by BEIS. As set



out in our response to Question 6 this could be achieved in a number of ways such as: (i) making changes to the institutional framework, with new bodies where needed, (ii) re-framing Ofgem's duties, or (iii) through the use of a SPS for Ofgem to deliver (as in water) or through joint working groups in relation to particular challenges or strategically important projects. Each of these have respective advantages, but the key will be ensuring appropriate alignment is achieved.

- 8.5. Use of such methods should also take account of ensuring Ofgem implements policy that supports a consistent approach and focus in the development of the means to achieve Net Zero – supporting both the development of electricity-based solutions and green gas so that it can in line with broader Government aims and for the benefit of consumers.

***20 August 2021***