

# Principles for the development of Scotland's gas and electricity networks

Produced by the Scottish Energy Networks Strategic Leadership Group

Membership of the Scottish Energy Networks Strategic Leadership Group:

- Scottish Government (Chair: Paul Wheelhouse, Minister for Energy, Connectivity and the Islands)
- SP Energy Networks
- Scottish and Southern Electricity Networks
- SGN
- National Grid Gas
- National Grid Electricity System Operator
- Ofgem

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## Introduction

The interaction between devolved Scottish policy and the reserved regulation of energy networks is becoming increasingly complex. The Scottish Government's targets for decarbonising the energy system and economy, along with ambitious targets for eradicating fuel poverty, have implications for the development and costs of the gas and electricity networks.

Ensuring that devolved and reserved policy areas work together to deliver shared objectives is a challenge recognised within and beyond Scotland. The need for strong working relationships between devolved administrations and national regulators was highlighted in recent reports from both the National Infrastructure Commission and the Infrastructure Commission for Scotland (see Table 1). It is also an issue raised by the Committee on Climate Change in its work to advise both UK and Scottish Government. It is a challenge recognised by the Scottish Government, Ofgem and Scotland's network companies, with a shared ambition to ensure that the system delivers for Scotland.

The Energy Networks Strategic Leadership Group (SLG) is co-chaired by Paul Wheelhouse, Scottish Government Minister for Energy, Connectivity and the Islands, and Professor Keith Bell. It brings together representatives from the Scottish Government, gas and electricity network companies operating in Scotland, the GB Electricity System Operator, Ofgem, and independent consumer representation. It provides a forum to develop our joint understanding of the way in which Scotland's energy networks need to develop.

As part of its work over the past year the SLG has focused on agreeing shared objectives and ambitions, aiming to improve the way that UK and Scottish organisations work together to deliver change – a process which has culminated in the principles set out in this document. These principles articulate a common purpose to deliver network infrastructure in Scotland, within the GB regulatory system, which can help Scotland to meet its wider policy targets, including those associated with climate change and fuel poverty.

Table 1: Recommendations of the NIC and ICfS

### **National Infrastructure Commission Regulation Report<sup>1</sup>**

Regulatory frameworks should reflect the devolution of powers within the UK:

- Ahead of the next price controls, regulators should put in place formal mechanisms, such as advisory committees, to ensure they have regard to the strategic vision set out by devolved administrations, where devolved and reserved powers interact
- In future price controls, regulators should demonstrate how they have taken consideration of the strategic vision of metro mayors and relevant local government, within devolved powers, where this has material impacts for network investment
- Regardless of specific devolved powers, regulators should engage with the views of elected representatives, alongside other sources of insight into consumers and the public's preferences.

### **Infrastructure Commission for Scotland<sup>2</sup>**

- Building on the findings of the recent UK National Infrastructure Commission review of Energy and Telecoms regulation, the Scottish and UK Governments should immediately commit to work together to develop by 2021, an appropriately devolved regulatory and pricing framework that enables energy and telecoms infrastructure investment to be planned and delivered to meet the future needs of Scotland.

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<sup>1</sup> <https://nic.org.uk/studies-reports/regulation/>

<sup>2</sup> [https://infrastructurecommission.scot/storage/281/Phase1\\_FullReport.pdf](https://infrastructurecommission.scot/storage/281/Phase1_FullReport.pdf)

## Context

The UK Government is responsible for energy network policy and regulation. Ofgem's roles and responsibilities, set out through UK Parliamentary legislation, include the regulation of gas and electricity networks, and determination of the regulated network companies' allowed revenues. Its principal duty is to 'protect the interests of existing and future consumers'. In its strategic priorities to the end of 2023, Ofgem says that consumers and stakeholders can expect it to "work with Government, industry and consumer groups to deliver a net zero economy at the lowest cost to consumers" and ensure "fair treatment for all consumers, especially the vulnerable"<sup>3</sup>.

Regulated networks, through the licences under which they operate, have responsibilities to facilitate security of supply, competition in energy supply, and the economic and coordinated development of the networks themselves. In broad terms, the network companies are required to meet the needs of network users and, in recent years, Ofgem has introduced stronger requirements on the companies to consult with and respond to their stakeholders.

While policy and regulation relating to the networks themselves are reserved matters, devolved policy can have substantial implications for the networks' future. For example, the Scottish Parliament has legislated for stretching climate change and fuel poverty targets. These are areas of devolved competency that will have major impacts on the gas and electricity systems. Meeting Scottish ambitions and legally binding targets in this area will depend on how energy networks are planned, regulated and funded.

Since September 2019, Scotland has had a statutory requirement to reduce greenhouse gas emissions by 75% by 2030 relative to 1990 levels en route to net zero in 2045, five years earlier than the UK as a whole.

Meeting Scotland's net zero pathway will require faster progress than in the rest of GB. For example, there is likely to be an accelerated need to upgrade the electricity networks in order to connect electric vehicles and heat pumps, and to integrate green gas into Scotland's gas networks. The Scottish Government's updated Climate Change Plan<sup>4</sup>, published in December 2020, lays out a pathway that includes zero carbon electricity generation from 2029. The plan also involves the decarbonisation of around 50% of Scotland's homes and non-domestic building stock, and a reduction in transport emissions of more than 40% between 2020 and 2030.

There are also important implications for the gas networks. The 2020 Scottish Hydrogen Policy Statement<sup>5</sup> lays out an ambition for 5 GW of hydrogen production capacity in Scotland by 2030. Meanwhile, the draft Heat in Buildings Strategy<sup>6</sup> highlights an ambition for green gas to constitute 20% of the gas delivered through our networks by 2030.

Scotland's fuel poverty targets<sup>7</sup> also mean that we need to think not only about the total cost of developing our energy networks, but also who pays for them. Ensuring that these costs don't fall on those least able to pay will be an important part of Scotland's Just Transition.

Meeting Scotland's devolved ambitions means working together. Network companies and Ofgem will still need to work within the GB regulatory framework, but can do so in a way that recognises, and can enable, Scotland's ambitions. The Scottish Government needs to consider the regulatory system's requirements and processes, and support the building of evidence which will ensure that investment decisions are quickly reached and well justified.

Helping deliver national targets is only one part of the story. There are growing local ambitions across Scotland, with each area possessing its own strengths, resources, expertise and

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<sup>3</sup> <https://www.ofgem.gov.uk/about-us/our-priorities-and-objectives>

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

<sup>5</sup> <https://www.gov.scot/publications/scottish-government-hydrogen-policy-statement/>

<sup>6</sup> <https://www.gov.scot/publications/heat-buildings-strategy-achieving-net-zero-emissions-scotlands-buildings-consultation/>

<sup>7</sup> <https://www.legislation.gov.uk/asp/2019/10>

priorities. The Scottish Government has worked with local authorities since 2017 to trial and demonstrate the potential for Local Heat and Energy Efficiency Strategies, and believes that these will play a critical part in meeting Scotland's heat decarbonisation ambitions.

The focus on local energy in Scotland is mirrored elsewhere in Britain. For example, Ofgem has supported work to develop an understanding of the potential for local area energy planning to influence decisions about network investment. Ofgem also referred explicitly to the Scottish Government draft framework for devolved regional and local planning in its RII0-ED2 Methodology Decision in December 2020<sup>8</sup>, relating to the electricity distribution network companies' price control period running from 2023 to 28.

### **Developing principles for Scotland**

The members of the Energy Networks SLG have co-produced and agreed this set of principles, which recognise and are designed to better enable the achievement of devolved targets, policies and ambitions within the relevant framework. These principles recognise the need for network companies and Ofgem to work within the existing GB regulatory system, as well as acknowledging and responding to the democratic mandate of the Scottish Government to deliver policy in areas of devolved responsibility.

The principles recognise the importance of delivering two distinct outcomes: enabling Scottish government policy and ensuring that major energy network decisions and developments are well justified. All members recognise that energy networks are funded from energy consumers' bills, and that decisions by the network companies and Ofgem need to ensure that consumers' money is spent effectively and efficiently.

The principles also acknowledge the importance of a pathway to net zero which can deliver a Just Transition that supports everyone in Scotland. This resonates with Ofgem's statutory duty to have particular consideration for vulnerable customers, and has been supported by Scotland's network companies, including through the development of network business plans.

The agreement and principles also support local energy planning. While the SLG does not aim to speak on behalf of all relevant local bodies, it does see the genuine importance of local as well as national ambitions and contributions to net zero, including those developed by local authorities and community groups.

These points and agreement are captured in the eight principles presented in the next section.

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<sup>8</sup> <https://www.ofgem.gov.uk/publications-and-updates/riio-ed2-sector-specific-methodology-decision>

## The Principles

1. The **Scottish Government** will work with the energy network companies and Ofgem to help develop well-justified network investments which anticipate and respond to the needs of Scottish energy policies, ambitions and targets.

This principle acknowledges the importance of well-justified decisions, recognising that network investment is currently funded by bill payers' money and that network companies and Ofgem have an obligation to ensure that this money is spent efficiently and effectively. It commits Scottish Government to playing a full part in the process of building evidence and supporting well justified decisions.

2. **Energy network companies** and **Ofgem** will take into account the effect of clearly established Scottish Government policy and targets where there is evidence that the policy ambition or target will be achieved, and hence change the volume of energy carried on the gas and electricity networks and the patterns of energy flows.

This principle acknowledges the Scottish Government's responsibility and mandate in areas of devolved competency. It means that Ofgem and the network companies acknowledge and commit, within their statutory duties and obligations, to take Scottish Government policies fully into account where these will have material impacts on the planning, development and operation of the networks.

Combined with the first principle, it places equal emphasis on the role of network companies, Ofgem and Scottish Government to work together to enable and deliver energy networks capable of delivering Scotland's energy policy targets and commitments, as well as the needs of network users in Scotland.

3. Consideration of Scottish ambitions and targets will include the **pace** at which change needs to be delivered, the **nature** of the relevant targets (e.g. whether they are statutory and legally binding) and the **criticality** of networks in enabling them to be met. **Network companies** will clearly set out this information in their plans and proposals, enabling **Ofgem** to consider how the regulatory framework can facilitate ambitions and targets.

The pace and scale of change needed to deliver government targets is increasing, with Scotland's ambitious 2030 interim Climate Change Target less than 10 years away. The development of our energy networks needs to match this pace. Where statutory targets, which the Scottish Government has a legal responsibility to deliver, depend on particular levels or types of investment in energy networks, then network companies and Ofgem should consider and take these targets into account, the latter continuing to do so on the basis of its obligation to ensure that network investment is in the interest of GB consumers.

4. There is uncertainty around the need for and timing of network investment, increasing the importance of a framework which establishes the types of **'good evidence'** required to support cases for such investment. Evidence should be concrete and specific, helping to grow confidence around three fundamental areas: how policy levers will be used to deliver change, how change will be financed, and the role of other stakeholders in delivering change.

This principle captures the importance of agreeing what constitutes good evidence. Where Scottish policies and targets require the network sector to invest faster, or to a greater extent, than in other parts of GB, the development of this evidence base will be an important part of ensuring that the right network investment and funding decisions for Scotland can be reached. Agreeing a framework within which evidence is delivered provides certainty to all parties as to what is needed and when.

5. Current and future consumers' interests will remain at the heart of decision making, consistent with Ofgem's statutory duties. This will mean taking into account the diversity of consumers' interests across different communities and how these vary across Scotland and GB both now and in the future. It will also mean identifying trade-offs and indicating clearly how those trade-offs have been considered in decision making.

This principle articulates the clear trade-offs that exist between different consumer groups, and that the interests of different consumers now and in the future will sometimes have to be balanced when considering whether network investment is appropriate to meet different levels of ambition in different parts of GB. As before, this needs to be delivered within Ofgem's statutory obligations. The regulatory framework needs to be sufficiently flexible to accommodate differences in policy between areas of GB, and the ways in which these differences will change over time on the pathway to net zero GHG emissions.

6. Energy network companies, Ofgem and the Scottish Government will consider the role that network investment can take in delivering a Just Transition, consistent with the network companies' licence conditions and the regulatory environment in which they operate.

Energy consumers will benefit from a growing economy, decent work and quality jobs, and decisions should take into account their effect in helping reduce inequality and poverty. This principle links to the Just Transition Principles and the work of Scotland's Just Transition Commission, as well as Ofgem's statutory duty to consider the interests of particular groups of vulnerable customers. However, it also goes beyond considering simply 'consumer impacts' in its link to potential economic and social benefits.

7. Network investments and the regulatory framework should consider Scottish Government's ambitions for sustainable economic growth, the development of local supply chains and strategies for decarbonising industry across Scotland.

An important aspect of a Just Transition is the need for sustainable economic growth, and there is clearly an important role for energy networks in industrial decarbonisation. The Energy Networks SLG members recognise the importance of strategic planning for industrial decarbonisation as an integral part of a net zero pathway.

8. The Scottish Government, network companies and Ofgem will respond to and enable well evidenced **local ambitions**, recognising that the capability of local authorities and local stakeholders to generate evidence to support network business planning will vary, and finding ways to help these organisations engage in the necessary way.

There is a wide variety of ambitions at local authority and community level across Scotland, driven by stakeholders and consumers in those areas. In many cases, the same issues as those addressed with respect to Scottish Government and devolved policy also apply to the role of energy networks in supporting these local ambitions, and the same principles should apply where that is the case.

This principle aims to extend these wider principles to a local level across Scotland, and to acknowledge that resource and knowledge limitations can be an issue for local authorities. If local ambition is to be delivered, it will be important to ensure that local authorities and other local organisations are supported.