Naturgy

Renewable Heat Obligation,

Business Energy & Gas Policy Team,

Department of the Environment, Climate and Communications,

29-31 Adelaide Road,

Dublin,

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By email only to RenewableHeat@decc.gov.ie

29th October 2021

RE: Consultation on Renewable Heat Obligation published 12 August 2021

To whom it may concern,

Naturgy Limited ("Naturgy") welcomes this long-awaited policy development and the opportunity to provide its views on the Department of the Environment, Climate and Communications' ("DECC" or "Department") consultation on Renewable Heat Obligation published 12 August 2021 (the "Consultation"). Naturgy provides its general comments and the overarching themes of our response to the Consultation (points A - J), before responding directly to each Consultation question.

As the first shipper and supplier of biomethane using the gas network to end users in Ireland, and as a member of the Renewable Gas Forum of Ireland (RGFI), we are keen to see growth in the domestic renewable heat industry with a view to enticing more users to the market and thus enabling the entry of more producers to the market. Naturgy fully supports and welcomes the DECC's initiative to spur growth in the renewable heat sector. The opinions outlined in our response are ultimately in support of policy progression in this sector. Any challenges or queries Naturgy presents should not be considered as creating obstacles to progression of this policy, but rather as constructive feedback to inform the decision-making process and enable the optimum policy environment for the renewable heat sector.

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General comments on the Consultation and the proposed design of the Renewable Heat Obligation (RHO) and the Consultation

A. Precedent: The Energy Efficiency Obligation Scheme (EEOS) – learnings from the EEOS as an Obligated Party to inform the RHO.

As an obligated party to the EEOS, which is broadly similar to the proposed design of the RHO, Naturgy has had in-depth experience with this comparable structure. Energy providers are now championing the benefits of reducing energy consumption, whilst looking to support their customers on these projects at the same time. Although there is no doubting the success of the EEOS to date in achieving its targeted energy savings, however, as the EEOS has matured, the low hanging fruit of obvious projects has slowly disappeared. This has created a situation where every subsequent targeted kWh energy saving is more onerous to procure by obligated parties due to the increasing difficulty and costs of achieving these savings, combined with the increased complexity of demonstrating compliance of those energy savings.

Furthermore, during the operation of the EEOS there has been a massive absorption by suppliers of the costs associated with obtaining and earning energy credits. In principle, the socialisation of energy credit procurement through suppliers may have been thought of as a good idea. However, in practice, we have seen that the reality is that energy consumers are not willing to accept new charges. Even those consumers that do initially accept this socialisation charge have eventually seen it competed away over time, as suppliers have had little option but to taking the EEOS as part of cost of sales. In summary, the EEOS has been a great initiative, but the structure has created a cost for suppliers that increases over time without a reasonable means to socialise the cost. This should provide some context for the opinions provided by Naturgy throughout our response.

B. Request to Publish Information

Naturgy requests the DECC to publish supporting analyses that informed this consultation, including analysis that informed the following:

- proposed obligation thresholds; and
- proposed penalty rates.

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C. Review of Competing Markets

Naturgy requests the DECC to publish the analysis and modelling which reviews the regulatory and market landscape in other jurisdictions and indeed other sectors within Ireland (such as transport). This should obviously and categorically demonstrate that sufficient renewable heat capacity is available to obligated parties for the purposes of a Renewable Heat Obligation, while accounting for the growth in demand for these same renewable fuels in other sectors, markets or jurisdictions.

D. Structure of the scheme: obligation vs. regulated tariff support / levy

According to the recent publication by the World Biogas Association[1], the most effective policy measure in the early stages of a biogas industry development is direct financial support. The success of such a policy measure in launching an early stages renewable industry has been demonstrated in Ireland with the introduction of the AER and REFIT schemes in the 2000s, funded by a PSO levy. The notable achievement of renewable electricity targets being achieved in 2020 demonstrates this point. Naturgy supports the concept of socialising the costs associated with procuring renewable heat, as is referenced in section 10.2 of the consultation. However, as referenced above in the learnings from the EEOS, Naturgy fundamentally disagrees that placing a renewable heat obligation on fuel suppliers will result in the fair socialisation of these costs across all heat users. The competitive pressures of the EEOS have led to obligated parties in that scheme internalising the costs associated with procuring energy credits. There is no evidence provided in the consultation to suggest that this will not reoccur in the operation of the RHO. These policy measures are being imposed on participants in a way that energy suppliers and providers of heat must absorb the related costs of implementation and make what was once a competitive market very uncompetitive.

Naturgy believes the RHO places an unfair burden on heat providers, many of whom are also obligated under the EEOS and thus have internalised many of the associated costs due to competitive pressures within the scheme. Naturgy believes that the fairest and truest socialisation of costs associated with procuring renewable heat can only be achieved through the support of renewable heat costs via a regulated tariff or levy, similar in principle to the operation of the PSO levy in the electricity sector.

[1] World Biogas Association - "*Biogas: Pathways to 2030*" March 2021, page 8: "*Overarching Policy Timeline*"

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E. Supply side vs. demand side measures

On DECC's webinar on the RHO on 5th October 2021, the DECC presented a slide stating that a supply-side measure is required to stimulate the renewable heat market; similar to how supply-side measures have stimulated renewable electricity production in the past (e.g. AER, REFIT, RESS). Naturgy agrees with this assertion that renewable heat market needs a similar supply side measure. However, in Naturgy's opinion, the RHO as proposed is a demand side obligation, as it is being placed on suppliers who ultimately represent demand side consumers. Naturgy believes a true supply-side measure to support renewable heat producers should be developed, in the form of a support scheme similar in principle to REFIT.

F. Motivating corporates to take ownership of renewable heat procurement (incentives, tax reliefs, rebates on RHO levy, etc.)

Naturgy proposes that DECC consider developing a framework within the scheme to enable corporate renewable heat procurement; similar in principle to the electricity sector targeting the procurement of 15% of electricity demand via Corporate Power Purchase Agreements and which would be in line with the Climate Action Plan. Industry has shown in the electricity sector that it is willing to take the lead on the procurement of renewable energy, especially in the context of increasingly stringent sustainability targets set by multinational companies. In addition, Naturgy proposes that DECC bring corporate consumers on the journey to procure renewable heat from the beginning by incorporating an "enabling incentives framework" within the RHO (or indeed whatever form the final policy implementation takes) for consumers who wish to procure renewable heat proactively. A separate analysis may be required to determine the most effective measures within such a framework, but Naturgy suggests drawing inspiration and taking the lead from the SEAI's CPPA consultation from March 2021, the responses to that consultation and the SEAI/DECC follow up expected in Q4 2021.

G. Encouraging the Circular Economy

The term "Circular Economy" does not appear in the RHO Consultation document, although we appreciate that the sustainability criteria of RED II will be a condition of the scheme. Naturgy believes that there is an opportunity in the introduction of the RHO to support the notion and enhance the development of a circular economy. This is especially important for renewable fuels of biological origin where the source of the feedstock to the biological process could be the same entity or facility as the

end user of the renewable heat. Practically speaking, this could be implemented by allowing for credit multipliers where a circular economy renewable heat procurement loop has been established and verified.

Naturgy's feedback from energy users suggests they are not motivated to engage in or create circular economies in relation to renewable heat. Providing their own food or other waste (counterintuitively) increases the cost of renewable heat procurement, due to the facility operator having to operate outside its pre-existing feedstock contracts. The RHO should be designed to remove barriers to the creation of a sustainable circular economy and reverse this issue. Admittedly, there is a risk with enabling the circular economy that needs to be addressed in the form of equal access to the renewable heat by all users.

H. Carbon Intensity of Heating Fuels

Naturgy believes the RHO scheme obligations should be calculated on the basis of the carbon intensity of the heating fuel, as opposed to a simple percentage volume threshold, in what could be described as a polluter pays principle. This helps incentivise moving away from more polluting fuels.

I. Naturgy Experience as a Supplier of Biomethane

Naturgy was the first shipper and supplier of biomethane using the gas network to an end user in Ireland. We are actively engaged with our customers' sustainability requirements in relation to energy procurement. There is significant corporate demand for renewable heat; however, the significant barrier to growth in this sector to date has been the biomethane premium being cost prohibitive for users.

J. Public Sector targets (similar to EEOS)

Naturgy believes that the public sector should be included as an obligated entity, similar to the Energy Efficiency Obligation Scheme.

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Consultation Questions and Naturgy's Responses

Q1: Do you think that a Renewable Heat Obligation is an appropriate measure to introduce?

Naturgy supports the policy progression in the renewable heat sector; we believe that this sector is in dire need of policy progression and support to enable growth. Given the value destructive nature of the EEOS for obligated parties, Naturgy believes the structure of the renewable heat obligation is not optimal and instead proposes points D, E and F above as an alternative structure.

Q2: If not, what alternative measures would you consider appropriate to increase the use of renewable energy in the heat sector?

Naturgy proposes points D, E and F above as an alternative structure.

Q3: Do you agree that the obligation should apply to all non-renewable fossil fuels used for heating as set out above?

Naturgy agrees that the obligation should apply to all non-renewable fossil fuels used for heating. Naturgy believes obligations should be related to carbon intensity of fuels, per point H above.

Q4: It is intended that electricity used for heating purposes and renewable/waste district heating systems would be exempt from this obligation, do you agree with this approach?

Naturgy does not necessarily agree that electricity used for heating purposes should be exempt from this obligation. The paper notes that the expectation is that more and more renewable energy will be available; however, the bulk of this will come from support schemes. Excluding electricity supplied for heating could be deemed to be discriminatory and to the detriment of participants obliged to provide heat from renewable sources. We do support the view that renewable/waste district heating systems would be exempt. In any event, it must be considered that there should not be undue burden added to the remaining heat users.

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Q5: Do you agree that the portion of fossil fuel input used in CHP plants to generate heat would be considered to be part of the obligation?

Naturgy agrees that the portion of fossil fuel input used in CHP plants to generate heat should be considered to be part of the obligation.

Q6: Are energy suppliers the most appropriate bodies to become the obligated parties in the heat sector?

Naturgy disagrees that energy suppliers are the most appropriate bodies to become the obligated parties in the heat sector. Naturgy believes a regulated tariff or a levy similar to the PSO is the most appropriate mechanism, as discussed in point D above. This tariff should be regulated by the Commission for Regulation of Utilities and implemented by the relevant distributing bodies, be that a supplier of products, TSO, DSO or other as appropriate depending on the fuel type.

Q7: Is the 400 GWh of energy supplied an appropriate level for a supplier to become obligated?

Naturgy believes this figure seems arbitrary, but agrees it is most beneficial to the industry to have a definitive minimum threshold, and that the suggested 400 GWh threshold is in line with the EEOS. For clarity, we believe that only the energy supplied above the 400 GWh level should be the basis for the obligation and not the full amount of energy supplied. Conversion factors for the purposes of assessing the supply of various fuels against this threshold should be made explicit by DECC.

Q8: Do you agree with the 2023 start date for the obligation?

Naturgy believes that 2023 is an ambitious start date, but we are encouraged by the ambition of DECC in this regard. Naturgy believes the 2023 start date should be monitored and flexible subject to the development of the renewable heat market and deployment of renewable heat facilities – noting that the industry may be subject to new planning or other licencing processes that could quickly make the 2023 start date unrealistic. We would draw DECC's attention to the significant timelines involved in getting a biomethane facility operational from concept to commissioning, as well as the various permits and accreditations required. If this start date is preferred by DECC, Naturgy suggests immediate and urgent action in progressing the renewable heat policy and ensuring these facilities to be fast tracked through planning.

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Q9: In terms of the obligation rate, do you agree with the proposed initial level of obligation of 0.5%?

Naturgy believes 0.5% obligation threshold should be monitored and flexible subject to the roll out and development of sufficient renewable heat facilities.

Q10: In terms of ambition for a 2030 target, what level of ambition do you think is appropriate?

3% minimum

5% medium ambition

10% higher ambition

Other?

Naturgy would encourage DECC not to be overly ambitious and suggests that the higher targets would be acceptable subject to ongoing monitoring of the development of the renewable heat market and deployment of renewable heat facilities to ensure it is indeed possible for Obligated Parties to comply. This will be a massive imposition on the same market participants who will be imposed with the much tougher targets in the redesigned EEOS.

Q11: Do you agree with the first obligation period being multiple years 2023-2025 to give the industry time to develop supply lines?

Naturgy agrees with the first obligation being across multiple years and would encourage DECC to consider further flexibility in this regard (e.g. rolling in 2026, 2027 etc. and carry-over of surplus credits into a subsequent obligation period) subject to the development of the renewable heat market and deployment of renewable heat facilities.

Q12: Once the first period 2023-2025 expires, do you agree with the obligation then becoming an annual obligation?

Naturgy believes that a cumulative target would be more beneficial than an annual target, this would allow flexibility for outages and over/under production of renewable heat in certain years. Naturgy notes that in the EEOS there is a discrepancy in that the target is set cumulatively, but assessed annually, creating apparent gaps in targets and adding to the confusion of the scheme. Naturgy suggests settling and operating on our preferred cumulative basis.

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Q13: Do you agree with suppliers being able to trade credits in order to meet their obligation?

Naturgy agrees suppliers being able to trade credits in order to meet their obligation.

Q14: Do you agree with allowing 10% carry over of renewable credits to be used in the following year's obligation?

Naturgy does not agree that only 10% of credits should be allowed carryover. Instead Naturgy proposes a cumulative target through to 2030, thereby allowing total carryover of all credits through to 2030.

Q15: What are the sustainable energy sources likely to meet the Renewable Heat Obligation at an obligation rate of (i) 3%, (ii) 5%, (iii) 10% by 2030?

Naturgy's response is based mostly on the provision of biomethane to meet these targets. We acknowledge that new fuels may also have a role to play including hydrogen. DECC must acknowledge that the chances of getting green hydrogen into the system as a competitively priced heat source are some way off, but undoubtedly should be encouraged and if anything should merit a quadrupling of a similar unit of renewable heat.

Q16: Will there be enough sustainable indigenous supply to meet this demand?

Naturgy would refer to the published KPMG analyses in this sector which appear to suggest that there is enough indigenous supply to meet this demand.

Q17: Do you agree that for renewable fuel delivered directly to a consumer that this will be the point of supply?

Naturgy requests DECC to publish further analysis around this question to demonstrate impact. Naturgy suggests that all renewable supply is verified and incorporated to a robust and recognised green tracking methodology such as the Guarantees of Origin and Proof of Sustainability systems.

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Q18: Which option to you think should be applied for renewable energy that is indirectly supplied (e.g. via the natural gas grid)?

Naturgy requests DECC to publish further analysis around this question to demonstrate impact. Naturgy suggests that all renewable supply is verified and incorporated to a robust and recognised green tracking methodology such as the Guarantees of Origin and Proof of Sustainability systems.

Q19: Do you think the costs set out above are reflective of likely costs?

No comment.

Q20: Are these costs reasonable to impose on consumers?

Naturgy suggests that a regulated tariff is a fairer and truer means of socialising costs of renewable heat across all users. Naturgy suggests DECC carefully consider design of the scheme to ensure undue pressure is not added to a relative minority of heat users.

Q21: Do you agree with the intended position in relation to penalties for non-compliance?

Naturgy believes penalties should be designed to encourage market development. Naturgy notes that twice the market rate being a basis for penalty is overly penal. Penalties should be considered in line with renewable fuel markets in other sectors and jurisdictions to ensure that renewable heat is indeed attracted to the scheme being proposed by the DECC.

Q22: Do you think the proposed obligation poses a significant risk to increased energy poverty?

Naturgy believes any increase in energy costs poses a risk to increased energy poverty and therefore needs to be carefully considered to avoid this.

Q23: How best could the impacts on energy poverty be minimised?

Naturgy proposes a regulated tariff across all heat users to ensure the cost is minimised as much as possible and not placing undue pressure on specific subgroups of users and could be rolled into the fuel allowance scheme. Naturgy proposes the DECC consider an exemption on renewable heat tariffs or costs for energy poor households.

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Q24: Do you agree with the outlined approach for additional support for green hydrogen?

Naturgy agree in principle, but it needs to be monitored and assessed in line with availability of hydrogen. This should scale with market so no party has unfair advantage in future. In terms of what the multiple, the multiplier should relate to the business case for hydrogen to address the technology gap vs. biomethane or other renewable heat sources and believe a factor of four (4), not just two (2) should be used. We want to encourage real investment of scale to ensure its success.

Q25: Do you think that offering multiple credits for green hydrogen in the heat sector might have unintended consequences for supply in other sectors such as transport?

Naturgy believes yes, if not monitored in line with availability of hydrogen, the technology gap needs to be reassessed each year. It would not be desirable for some parties to have an unfair amount of or access to hydrogen credits in future when hydrogen is more readily available and the technology gap has subsequently reduced. There is little doubt that this may impinge on the development of a greener transport fleet. There will therefore need to be combined and joined up thinking to ensure no sector is too negatively discriminated against.

Yours sincerely,

[redacted]

Renewables Department