

Allan Rankine
Senior Analyst – Networks
The Office of Gas and Electricity Markets
10 South Colonnade
Canary Wharf, London, E14 4PU

Tony Nixon
Regulation Director, Gas Transmission
tony.nixon@nationalgrid.com
Tel: +44 (0) 7973 236 122
www.nationalgrid.com

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Dear Allan,

Statutory consultation on modifications to the Gas Transporters' RIIO 2 NZASP re-opener licence conditions.

Thank you for the opportunity to respond to the above-mentioned consultation. This non-confidential response is provided on behalf of National Grid Gas Transmission.

We support the intent of the proposed modifications to the NZASP re-opener mechanism, and think these will be beneficial to furthering valuable decarbonisation projects in RIIO-2, at the same time protecting consumer interests:

- The energy sector needs to be able to move at pace to deliver 2050 net zero ambitions, and the proposal to increase the maximum funding level of the mechanism to £100m will be enabling to vital early hydrogen infrastructure works and other societally valuable decarbonisation projects that will be required within the RIIO-2 price control period (subject to the NZASP mechanism trigger, application and determination processes).
- Because development of the GB hydrogen market is in its infancy, we consider that early hydrogen investments made in the current price control period (e.g., larger scale innovation projects not suited to the Network Innovation Allowance or Strategic Innovation Fund, trials and infrastructure feasibility works) are not suited to standard RIIO-2 totex treatment and incentivisation. We are therefore supportive of Ofgem's proposals which in essence enable "pass through" style funding for such projects, whereby there is an opportunity to return any unspent allowances to consumers.
- We support Ofgem's proposal to make the Net Zero Pass Through term (NZPT) available for use by National Grid Transmission, as this will allow consistent treatment of RIIO-2 hydrogen investments across the gas sector.
- The effects of the proposals are such that standard totex treatment and incentivisation can still be applied to projects put forwards under the NZASP mechanism where this is appropriate, for instance where projects relate to investments on the natural gas network.

In the annexes that follow this letter, we make some supplemental observations to assist with implementation and operation of the proposals for Ofgem's consideration. We also provide comments and suggestions on the proposed drafting of the relevant licence conditions, and the proposed updates to the NZASP governance document.

If you have any questions or comments regarding this response, or require any further information, please do not hesitate to contact Craig Neilson, Future Regulatory Frameworks Manager (craig.neilson1@nationalgrid.com).

Yours sincerely,

[by email]

Tony Nixon
Regulation Director, Gas Transmission

Annex 1: general observations on Ofgem's proposed modifications to the Gas Transporters' RIIO 2 NZASP re-opener licence conditions

1. The proposals provide a range of options for the regulatory treatment of projects proposed under the NZASP mechanism, but we think the option to return unspent funds to consumers should only apply where the NZPSt route is taken and not to the NZPt route. This is because the NZPt route is configured in the RIIO-2 Price Control Financial Model (PCFM) to be subject to totex incentivisation, which would be inconsistent with an unspent funds return. However, we also note that the NZASP mechanism does not describe a process for setting Price Control Deliverables (PCDs) which is the case for other re-openers (including the Special Condition 3.6 Net zero Re-opener and Price Control Deliverable mechanism) which would appear to be an inconsistency. We note that the NZASP governance references the option to use PCDs, and this might be an appropriate way to protect consumers where the NZPt route / totex treatment is adopted.
2. We would expect that NZASP projects that involve physical asset investment on the natural gas network would be subject to the NZPt funding route, making them subject to re-opener totex capitalisation rates and totex incentivisation as configured in the RIIO-2 PCFM. We see the NZPSt route (including the option to return unspent allowances) as being appropriate for larger scale innovation projects not suited to the Network Innovation Allowance or Strategic Innovation Fund, Hydrogen trials and hydrogen infrastructure feasibility works. The NZASP governance document requires networks to make proposals for the regulatory treatment of costs at both the pre and post-trigger application stages, which we think supports objective discussion in this regard as part of due engagement with Ofgem.
3. The NZASP governance document requires networks to make proposals for direct company contribution to projects. To the extent that network contributions are made as part of NZASP project application and determination, this should be duly taken into account in the instance where unspent allowances are returned to consumers (i.e., the return adjustment should include a proportionate adjustment in respect of the network's contribution).
4. Whilst Ofgem's proposed modifications include provision for the return of unspent allowances to consumers, we think there also need to be processes to consider legitimate cost overruns, particularly for projects that are externally driven, and perhaps adjustments in either direction could be considered by a formal project close out process.
5. Where NZASP project directions involve the transfer of funds between National Grid Gas Transmission (NGGT) and Gas Distribution Networks, it is important that the price basing of physical funds transfers is duly considered. This is because Ofgem's directions (and associated PCFM updates) are expressed in 2018/19 prices, but NGGT will collect revenue in nominal terms. To ensure neutrality of the arrangement on the NGGT side, the funds distributions should be made in nominal terms. We do not think this requires licence modification but should be clarified within NZASP project directions.
6. Whilst we accept that this is outside the scope of this consultation, and constrained by future policy decisions, the early planning for the regulatory treatment of hydrogen investments involving physical asset construction will be important to ensure that hydrogen infrastructure can be developed at the pace required to meet Net Zero targets. We are committed to supporting BEIS and Ofgem in the development of the regulatory framework for hydrogen (including any required interim arrangements in the current and future price control periods).

Annex 2: proposed modifications to Gas Transporter Licence Special Condition 1.1 Interpretation and Definitions Part B – Small Net Zero Projects

The proposed drafting ties the definition of “Small Net Zero Projects” to paragraphs 3.6.6 (a) to (d) of Special Condition 3.6 Net zero Re-opener and Price Control Deliverable, which refer to a “Net Zero Development”, which is defined in Special Condition 1.1 as follows:

Net Zero Development

means a change in circumstances related to the achievement of the Net Zero Carbon Targets that is:

- (a) a change in national government policy (including policies of the devolved national parliaments);*
- (b) a change in local government policy;*
- (c) the successful trial of new technologies or other technological advances;*
- (d) a change in the pace or nature of the uptake of low carbon technologies; or*
- (e) a new obligation arising from the agreement of a Local Area Energy Plan or an equivalent arrangement.*

Our observation is that the cross reference to “Net Zero Development” is restrictive for circumstances where there a strong Net Zero based needs case for a project proposed under the NZASP mechanism, but this is not necessarily triggered by the events included in the definition above. We therefore propose the following alternative wording for the definition of “Small Net Zero Projects” in SpC 1.1:

Small Net Zero Projects

means a project that is:

- (a) aimed at furthering the achievement of Net Zero Carbon Targets, including building the evidence base to support related future government and regulatory policy decisions; and*
- (b) has a project value greater than £1m, but does not exceed £100m*

We think this definition is more consistent with the intended broad scope of the NZASP mechanism as described in paragraph 2.2 in the NZASP governance document.

Annex 3: proposed modifications to Gas Transporter Licence Special Condition 3.9 Net Zero Pre-construction Work and Small Net Zero Projects Re-opener (NZPt)

We broadly agree with the proposed drafting of SpC 3.9, but suggest some minor amendments as below:

3.9.1 The purpose of this condition is to establish a Re-opener triggered by the Authority where pre-construction work or other projects have been identified that will ~~enable~~ support the achievement of Net Zero Carbon Targets.

3.9.4 The Authority may use this Re-opener where:

- (a) there is Net Zero Pre-construction Work or Small Net Zero Projects needed that will ~~enable~~ support the achievement of Net Zero Carbon Targets;*

- (b) *the Net Zero Pre-construction Work or Small Net Zero Project has caused or is expected to cause the cost of Licensed Activity to increase during the Price Control Period; and*
- (c) *the effect, or estimated effect, of the Net Zero Pre-construction Work or Small Net Zero Project on the cost of Licensed is not otherwise provided for in this licence.*
- (d) *the effect, or estimated effect, of the Net Zero Pre-construction Work or Small Net Zero Project on the cost of Licensed has not already been assessed under another Re-opener; and*
- (e) *the effect, or estimated effect, of the Net Zero Pre-construction Work or Small Net Zero Project on the cost of Licensed Activity exceeds the materiality threshold of £1m but does not exceed £100m.*

Note: the addition of points (c) and (d) in paragraph 3.9.4 above are intended to mirror equivalent points in SpC 3.6 Net zero Re-opener and Price Control Deliverable.

Annex 4: proposed changes to Gas Transporter Licence Special Condition 6.1 Transportation owner pass-through items (PTt)

We broadly agree with the proposed drafting of SpC 6.1, but suggest some amendments as below:

6.1.3 *The value of PTt is derived in accordance with the following formula:*

$$PTt = RBt + Lft + EDEt + OPTCt + Ist + PTVt + Hyt + NZPSt$$

where:

NZPSt means the sum of:

- (a) *the net amount transferred between the licensee and the Distribution Networks in accordance with Part F of this condition and Special Condition 3.9 (Net Zero Preconstruction Work and Small Net Zero Projects Re-opener) of the GDN licence, plus*
- (b) *in respect of the licensee, the value directed by the Authority in accordance with paragraph 6.1.11 (b) of this condition.*

6.1.14 *Where applicable, the licensee must pay the relevant Distribution Network the amounts specified in Appendix 2 divided equally on a quarterly basis for the relevant Regulatory Year, or in such other instalments as agreed between the licensee and the relevant Distribution Network.*

The intention of the proposed drafting of the NZPSt is simply to provide a little more clarity by separating the GDN and NGGT effects in the light of the broadened scope of the term.

For appendices 1 and 2 in SpC 6.1, we suggest it would be useful to confirm the price base of the values in question, which we would expect to be in 2018/19 prices.

For appendix 2, we suggest retitling to: “**Net Licensee Funding and Payments to Distribution Networks for Net Zero Pre-construction Work and Small Net Zero Projects (£m in 2018/19 prices).**”

To ensure full alignment with Ofgem’s funding directions, and accuracy in the associated updates to the RII0-2 Price Control Financial Model, we think that Appendix 2 should be expressed to 3 decimal places. We also observe that the SGN line is missing £2.5m in respect of Regulatory Year 2024/25 in line with [Ofgem’s direction for the LTS Futures Project](#). Taking these into account, the amended appendix 2 would show as follows:

Network / Regulatory Year	2021/22	2022/23	2023/24	2024/25	2025/26
Cadent Gas Limited	0.000	3.384	0.000	0.000	0.000
National Grid Gas plc	0.000	0.000	0.000	0.000	0.000
Northern Gas Networks Limited	0.000	5.739	0.000	0.000	0.000
Scotland Gas Networks plc	0.000	13.360	7.920	2.500	0.000
Southern Gas Networks plc	0.000	0.000	0.000	0.000	0.000
Wales and West Utilities Limited	0.000	0.000	0.000	0.000	0.000

Annex 5: proposed modifications to the Net Zero Pre-construction Work and Small Net Zero Projects Re-opener Governance Document

We have no comments or objections to the proposed revisions to the NZASP governance document.