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31st August 2018

Re: RIIO-T1 reopener consultation: Industrial Emissions Costs

Dear Kiran,

This response is submitted by National Grid Gas Transmission (NGGT). We own and operate the gas transmission assets in Great Britain (GB).

We do not support Ofgem's initial view to reduce our funding application for costs to achieve Industrial Emissions legislation, for the following high level reasons.

- We disagree that our proposed works at Peterborough and Huntingdon should not be funded through this mechanism and consider that Ofgem's current position contradicts the clarity that we had been given through the Mid Period Review (MPR) Parallel Work decision.
- For St Fergus and Hatton, we have provided sufficient information for Ofgem to (a) review and confirm the needs case for the investments and (b) confirm the funding decision as the works are considerably more advanced than most funding requests.
- For the remaining sites, we disagree that works triggered by the Industrial Emissions legislation should not be funded through this mechanism. We consider that Ofgem's current position contradicts the agreement contained within Final Proposals.

We believe the following arguments are significant enough for Ofgem to reconsider its position and we have addressed each point in turn.

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Peterborough and Huntingdon

Ofgem Question: *What do you think of our view at Peterborough and Huntingdon?*

The information provided by Ofgem in the consultation document, is in our opinion not an accurate representation of the approach set out by Ofgem for NGGT to continue to find ways to deliver lower cost solutions to meet the output for environmental legislation agreed in Final Proposals and maintained under MPR. Based on the following, we maintain that additional funding is required under the IED reopener as requested.

The regulatory output for Peterborough and Huntingdon was set in 2012 by Ofgem as part of RIIO-T1 Final Proposals as compliance with IPPCD Phase 3 for both Peterborough and Huntingdon (Cost assessment and uncertainty supporting document, table 7.7). We maintain that this is still the regulatory requirement and can be delivered by a single compressor unit at each site.

During 2014 we engaged extensively with all stakeholders, including the environmental agencies, on our proposals for IPPC phase 4 and the interaction with IPPC phase 3. This culminated in our 2015 reopener submission that clearly indicated that compliance with phase 3 output through existing allowances being achieved by the installation of one gas unit at each site, and that compliance with IPPC phase 4 and the Medium Combustion Plant directive (MCP) would be achieved through installing two further units at each site. We believe this was accepted by Ofgem and the installation of smaller unit to achieve the IPPC Phase 3 output directly led to the need for the MPR Parallel Work.

We have reported our approach throughout RIIO-T1 and explained through our annual regulatory reports and the Ofgem cost assessment visits the complete solutions required for both Peterborough and Huntingdon. In addition, once we had identified the need to build two units for IPPC Phase 3 and 4 at each site, we took the opportunity to combine the procurement processes and construction to minimise system outages and drive further efficiencies for customers.

Ofgem were fully aware of our proposals to install three units at both Peterborough and Huntingdon, along with the split of costs between IPPC phase 3 and 4. We had presented costs as part of our Regulatory Reporting Pack (RRP) in July 2016. Then in the subsequent RRP review by Ofgem in October 2016, the RRP information clearly identified that NGGT would need to exceed allowances by **£83m** in order to deliver all the works which would have been used by Ofgem in making their MPR decision.

The emissions output compliance was reviewed by Ofgem as part of MPR Parallel Works in 2017 based on the information we provided. In the MPR consultation of February 2017, Ofgem indicated that our latest cost forecast to achieve the regulatory output was an underspend of **£25m** against an allowance of **£143m**, which was broadly in line with our latest RRP submission for achieving IPPC Phase 3 by the installation of one unit at each site and IED Phase 1 using emissions abatement. Based on this position and our regulatory submissions it was clear any further legislative requirements would be funded through the reopener as planned prior to the MPR.

If Ofgem had intended a significant change to the RIIO-T1 output scope to consider the delivery of all works at each site as part of MPR, Ofgem should have consulted and made it clear to customers, stakeholders and NGGT that the latest forecast was an overspend of **£83m** in order to

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achieve compliance with three new units at both Peterborough and Huntingdon. Indicating an underspend in MPR is entirely misleading to those who responded to the consultation and would have significantly changed their response position. We have included the timeline (Appendix 1) specifying information that had been shared at various stages to keep Ofgem informed. This demonstrates Ofgem's awareness of our proposals at all stages, which we do not believe has been taken into account as part of Ofgem's assessment of our submission.

Following the MPR decision, NGGT then submitted the 2017 RRP and following which Ofgem held a meeting in October 2017 to assess our current financial and output position. This covered our financial performance and reviewed our reopener financial summary including our IPPC Phase 4 works at Peterborough, Huntingdon, and St Fergus. No challenge was raised by Ofgem that we had incorrectly allocated costs and in turn overstated our performance in meeting our environmental outputs. Ofgem's published report stated our cost saving performance on compressors and indicated that following the MPR decision NGGT is now undertaking different, lower-cost projects at these stations to achieve compliance.

We also believe it is inappropriate to consider performance on other projects, such as Aylesbury, as a means of justifying allowances elsewhere. There are two distinct outputs for IPPC phase 3 and one for IED phase 1, and the delivery and costs should be assessed individually. In addition, the extrapolation of the output definition is inconsistent with all previous phases of IPPC emissions works at St Fergus, Hatton and Kirriemuir, where there remain a number of units that have not been addressed on each site.

The IPPC process and the phased approach to the work we have agreed with the environmental agencies has maximised emissions reductions from the compressor fleet whilst minimising expenditure. This has been to the benefit of consumers and we believe this is an example of good practice being undermined by regulatory uncertainty introduced by Ofgem.

We have also provided evidence to Ofgem that if we had installed a 24MW electric drive for IPPC phase 3 compliance exactly as specified by Ofgem in setting the allowance, we would have still needed to install a further 15.3MW unit for IPPC phase 4 compliance. It would appear Ofgem would have funded a 15.3MW unit as part of IPPC phase 4 alongside a 24MW unit under IPPC phase 3. However, according to Ofgem's initial view they are not proposing to fund a 15.3MW unit as part of IPPC phase 4 in addition to a 15.3MW unit as part of phase 3, which is a lower cost solution for GB consumers.

Since this time, the only aspect of our proposal that has changed is the removal of the third unit, due to MCP legislation implementation date moving from 2025 to 2030, which has allowed us to delay the investment and reduce costs in RIIO-T1 for our customers. Again, it is through our engagement with the environmental agencies that has influenced the MCP implementation date, which represents a significant saving in RIIO-T1 for customers. Our comprehensive cost benefit analysis (CBA), also confirmed a delay to one of the units was the most economical solution.

We therefore believe that Ofgem need to reconsider their position as currently it introduces considerable regulatory uncertainty, contradicts all previous positions on RRP and MPR since 2015 and is not in the interest of consumers.

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St Fergus and Hatton

Ofgem Question: *What do you think of our view at St Fergus and Hatton?*

Needs Case

As per Final Proposals and Ofgem's decision on the May 2015 reopener, we have developed a comprehensive CBA of the options for both sites, and are now progressing the recommended solutions to the next stage of development. As an economic and efficient network operator, we will always keep these decisions under review, however for St Fergus and Hatton, the expected range of uncertainty of the final solution is very narrow.

Based on the information we have provided we would expect Ofgem to confirm the needs cases so we can proceed with the investment or provide a justification as to why the needs case cannot be agreed now.

Cost Proposals

The options proposed are considerably more advanced than most funding requests and a suitable output that caters for any change in the final solution can be agreed through this process. We have summarised our internal governance process below and for both sites we are now into Front End Engineering Design (FEED). At Hatton, we are only progressing one recommended option to FEED. At St Fergus, we have two options that within the RIIO-T1 price control have a forecast difference in funding request of just £4m. Therefore, unless there is a justification as to why the needs case is not accepted, we do not understand the reasons for not agreeing the funding at this juncture.

Sanction Stage	Activity
T1	Accept Need Case – COMPLETE
F1	Initial Sanction – COMPLETE
F2	FEED sanction and/or feasibility sanction – ONGOING
F3	Conceptual design sanction and sanction of long lead items
Above delivered in RIIO-1	
F4	Detailed design and build sanction
F5	Project closure
Remainder Delivered in RIIO-2	

We think certainty at this stage is extremely important as Ofgem, in paragraph 3.14 are intimating that they may not approve the course of action we are taking. Ofgem discuss carrying out work now, where emission restrictions may not apply after 2030 however all the relevant legislation (including the MCP) is already transposed into UK law. This contradicts previous requests by Ofgem as part of Final Proposals and the 2015 reopener to develop an integrated plan and a robust CBA that takes into account all relevant factors. Therefore, our concern is that as we progress solutions and invest in their development, Ofgem later rejects the costs we have incurred and the solution we have adopted. These costs for St Fergus and Hatton are forecast to be over £50m by the end of the price control. We note Ofgem's proposal to address this at the end of the price control. However, due to the uncertainty in Ofgem's position this gives us no confidence in progressing work at this stage. In the May 2015 decision, Ofgem committed to work with National

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Grid to ensure both parties were clear on requirements, to avoid a future unsuccessful reopener process. This did not happen, and therefore our concerns in relation to this reopener remain.

At both sites, there is a need to deliver solutions to ensure environmental compliance by 2023. This requirement means we need to progress with these programmes sufficiently over the next three years, with the remaining investment in the early part of RIIO-T2 to ensure we achieve environmental compliance by the deadline. Without this progress, we will be unable to operate the units beyond 2023 which introduces risk of network constraints from this point forwards. Introducing a stand still period until a decision is made on funding by Ofgem would jeopardise the project delivery, which is not in the interest of consumers.

<u>The remaining sites</u>

Ofgem Question: *What do you think of our view at the remaining sites?*

At final proposals Ofgem created a framework that provided £202m of CAPEX and £67m of OPEX to fund the most appropriate solutions to address the impact of industrial emissions legislation. Paragraph 3.81 in Ofgem's consultation states '*we "welcome NGGT's revised approach to consider potentially more cost–effective solutions in order to deal with the environmental legislation'' and acknowledge that NGGT was considering a wide range of options including decommissioning, retrofitting, exchange of non-compliant turbines etc'*. This framework was introduced because National Grid had originally proposed to replace on a like for like basis all affected units. This was in part due to the uncertainty of the legislation at this point and we therefore had not requested funding for ongoing asset health costs or decommissioning of affected units within the price control period.

The framework agreed as part of Final Proposals clearly recognises that solutions that do not necessarily affect the emissions performance of the units would be funded e.g. decommissioning, and OPEX actions. Ofgem did not raise any concerns about our proposals in the May 2015 reopener where we included decommissioning and asset health works as part of the funding request. The work proposed as part of this reopener submission for the remaining sites is triggered by the industrial emissions legislation and is thus consistent with the licence requirements. Funding has not been provided through any other mechanism. Since 2015 Ofgem have changed their position and are now inconsistent with Final Proposals.

It should be noted that the position at Carnforth is slightly different, where we are proposing integration works to enable Unit B to be decommissioned. This is the lowest cost option, however if Ofgem choose not to fund this work then we will need to consider whether Unit B should be replaced. We therefore believe that Ofgem need to reconsider their position as it currently introduces considerable regulatory uncertainty which is not in the interest of consumers.

<u>Stakeholder engagement</u>

Stakeholder engagement is an important part of the RIIO Framework. We have engaged extensively over a 4 year period to ensure our proposals and range of options would meet stakeholder requirements. Our proposals in 2015 and 2018 have received broad stakeholder support and our stakeholders have devoted significant time to their development. Ofgem risk alienating stakeholders when all parties have engaged and supported solutions that they believed were available and indicated throughout the RIIO-T1 framework.

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In summary, when we entered the RIIO price control, the overall cost of delivering IPPC phase 3 and 4 and IED requirements was forecast to be £269.3m[1] under Final Proposals. Based on our reopener submission, this cost would be reduced to £123m in the RIIO-T1 period[2]. National Grid has worked with stakeholders and the environmental regulators to reduce the cost to consumers of environmental compliance and we have addressed all of Ofgem's concerns from the May 2015 reopener. This consultation introduces further regulatory uncertainty and the inconsistency of approach is undermining our ability to fund the programme of works in an efficient and effective manner. We urge Ofgem to reconsider their position in the consultation and fund the works as proposed.

We hope you find this response helpful. If you would like to discuss any of the above please do not hesitate to contact me.

Yours Sincerely

Tony Nixon
Head of Gas Transmission, UK Regulation

[1] RIIO-T1: Final Proposals for National Grid Electricity Transmission and National Grid Gas Cost assessment and uncertainty Supporting Document, 2009/10 price base excluding RPEs
[2] NGGT 2017/18 Regulatory Reporting Pack, 2009/10 price base

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Appendix 1 – IED timeline of key regulatory communications

Due to the similarities between Peterborough and Huntingdon, we refer to Peterborough in the following text, but this equally applies to Huntingdon. We have included a separate attachment (IED Consultation timeline) with the extracts from the key documents.

Final Proposals – December 2012

Clarity was given as part of RIIO-T1 that ex ante funding had been agreed for Peterborough with the output defined as achieving IPPC Phase 3 compliance.

In addition, Ofgem indicated that the size of the compressor should be a 24MW electric drive.

IED reopener submission – May 2015

Clarity was given in our reopener submission that, due to customer supply changes, assumptions from our RIIO-T1 business plan and following detailed engineering design assessments, the build solution was to install a 15.3 MW gas unit to meet IPPC Phase 3.

In addition, we identified that there was a new requirement for two additional units to meet IPPC Phase 4 (a total of 3 units to achieve full compliance of IPPC 3, IPPC 4 and MCP). Again, as part of our RIIO-T1 business plan there was no expectation of further works at the site as other sites (i.e. Alrewas, Wormington, Diss) had been forecast to have the next compressors to be included in Phase 4 due to expected emission levels.

MPR consultation – November 2015 to January 2016

Ofgem outlined as part of their proposed scope for MPR that NGGT had installed smaller units in addition to the Aylesbury site where we installed a lower cost catalyst solution. Ofgem did not believe the change in scope and size was in alignment of the output.

We responded to clarify that the change had been driven by the Best Available Technique assessment as obligated by the environmental agencies.

Regulatory Reporting Pack review (15/16) – October 2016

Following our RRP submission, Ofgem held a meeting to assess our current financial and output position. This covered in detail our IPPC Phase 3 and IED plans. We presented the solution to install a 15.3MW unit and the latest cost forecast for these sites to meet IPPC 3.

Future costs were also given for Phase 4 and specifically identified the spend required to meet IPPC Phase 4 at Peterborough would require an additional XXXX. [Figure redacted]

In summary, our regulatory submission was clear that we had forecast £112m to meet IPPC Phase 3 at both sites and IED Phase 1 compliance at Aylesbury, which would be an outperformance of £40m

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using a regulatory allowance figure of £152m[3]. For full IPPC Phase 4 compliance at both sites our cost forecast would have been £226m or £83m[4] above allowances.

MPR Parallel work consultation – February 2017 to April 2017

Ofgem stated that their focus was on the output purpose and compliance with IED. This is a generic statement and could be misinterpreted. However, in support of the statement Ofgem laid out that NGGTs latest cost forecast estimates an underspend of £25m against an allowance of £143m, which was broadly in line with our latest RRP submission for achieving IPPC Phase 3 and IED Phase 1, i.e. compliance with final proposal regulatory output rather than the asset specific solution.

The full set of solutions and costs to achieve was presented in our RRP submission and in the RRP review in October 2016, which indicated the cost to install all three units and phasing.

MPR parallel work decision – July 2017

Ofgem stated they would maintain the approach from the consultation, considering the output delivered if NGGT complies with the IED, in a way that delivers the greatest value to consumers.

Regulatory Reporting Pack review (16/17) – October 2017

Following our RRP submission, Ofgem held a meeting to assess our current financial and output position. This covered our financial performance and reviewed our reopener financial summary including our IPPC Phase 4 works at Peterborough, Huntingdon, and St Fergus.

No challenge was raised by Ofgem that we had incorrectly allocated costs and in turn overstated our performance in meeting our environmental outputs.

Ofgem's published report stated our cost saving performance on compressors and indicated that following the MPR decision NGGT is now undertaking different, lower-cost projects at these stations to achieve compliance.

IED reopener – May 2018

Our submission proposal is to install one 15.3MW unit to comply with IPPC 4 at Peterborough and Huntingdon, and this is acceptable to the Environmental Agency. We have proposed solutions to ensure IPPC and IED compliance for St Fergus, Hatton and the remaining sites. Our approach to meet the environmental legislation, developed through the integrated plan and robust CBA, thereby delivers maximum value for consumers.

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[3] In external documents this is be quoted as £143m due to exclusion of IQI and RPEs
[4] Based on the external published figure of £143m