

# Guidance

## Net Zero Pre-construction Work and Small Net Zero Projects Re-opener Governance Document

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**Contact:** Gas Development Team

**Team:** Networks

**Email:** [gasnetworks@ofgem.gov.uk](mailto:gasnetworks@ofgem.gov.uk)

This Governance Document is for the Net Zero Pre-construction Work and Small Net Zero Projects Re-opener.

It sets out the arrangements for gas transmission and gas distribution network companies to use this re-opener – including details on the scope, process, and materiality thresholds.

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Any enquiries related to the text of this publication should be sent to Ofgem at:  
10 South Colonnade, Canary Wharf, London, E14 4PU. Alternatively, please call Ofgem on 0207 901 7000.

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## 1. Introduction

### **The Net Zero Pre-Construction Work and Small Net Zero Projects Re-opener**

1.1. The Net Zero Pre-construction Work and Small Net Zero Projects Re-opener (NZASP)<sup>1</sup> was created to allow gas distribution (GD) and gas transmission (GT) network companies to undertake early design, development, general pre-construction work, and net zero facilitation capital projects that will enable the achievement of Net Zero Carbon Targets<sup>2</sup>.

### **NZASP Governance Document**

1.2. This document is the Net Zero Pre-construction Work and Small Net Zero Projects Re-opener Governance Document. It is issued by the Authority under Special Condition (SC) 3.9.6 of the Gas Transporter Licence. It sets out the governance and administration of this re-opener.

1.3. In this document we use the terms 'Ofgem' and 'the Authority' as well as the terms 'we', 'us' and 'our' interchangeably. Ofgem is the Office of the Gas and Electricity Markets. The Authority is the Gas and Electricity Markets Authority and is the governing body of Ofgem, consisting of non-executive and executive members.

1.4. In this document "network licensee" means the holder of a gas transporter licence in relation to its gas distribution or gas transmission activities, regulated through the RIIO price control framework.

### **Compliance**

1.5. Network licensees are required to comply with this governance document in accordance with SC 3.9.3.

### **Review**

1.6. Ofgem may from time to time, following consultation with network licensees and other interested parties, revise this NZASP Governance Document in accordance with Part B of SC 3.9.

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<sup>1</sup> Gas Transporter Special Condition 3.9.

<sup>2</sup> As defined in Special Condition 1.1 of the Gas Transporter Licence

## 2. Scope, Process and Materiality Thresholds

### Scope and Eligible Projects

2.1. The NZASP is an Authority-only triggered re-opener. The Authority can trigger the re-opener at any time when the conditions set out in Part A SC 3.9 of the re-opener are met and will do so by asking network licensees to submit a detailed application, in line with the Post-Trigger Detailed Assessment phase outlined in Table 1 below.

2.2. The NZASP has a broad scope. Some examples of projects that may fall under the NZASP include:

- early development, design and general pre-construction work that will enable the achievement of Net Zero Carbon Targets<sup>3</sup>;
- Front-End Engineering Design (FEED) studies, conceptual design pre-FEED and general feasibility work required for large capital projects;
- Net Zero projects that exceed the £2m materiality cap of the Net Zero and Re-opener Development use-it-or-lose-it allowance (NZARD UIOLI) or are otherwise not suitable for the NZARD UIOLI; and
- Net Zero facilitation (green Gas and hydrogen) projects and hydrogen projects that are required as part of the Department for Business, Energy & Industrial Strategy Hydrogen Grid Research and Development Programme, including projects that may be interpreted as innovative – where there is a clear need and it is appropriate for network consumers to fund.

2.3. We may, over time, update the list above in accordance with Part B of SC 3.9.

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<sup>3</sup> As defined in Special Condition 1.1 of the Gas Transporter Licence's held by National Grid Gas plc and the Gas Distribution Networks.

<sup>4</sup>The materiality threshold for each network licensee is defined in Special Condition 1.1 of the Gas Transporter Licences.

### **Materiality Threshold**

- 2.4. The materiality threshold for this re-opener is £1m per project. Licensees may not achieve this threshold by aggregating different types of projects.
- 2.5. The materiality threshold may be met through anticipated costs.
- 2.6. For Small Net Zero Projects, the funding provided per project under the NZASP may not exceed the total of £100m.

### **Process**

- 2.7. There is a wide spectrum of projects that may come through this re-opener so applying a rigid, uniform process for it to be triggered may not be appropriate.
- 2.8. To achieve agility in our decision making, we will actively engage with relevant stakeholders to establish, in principle, the needs case for an investment before the re-opener is triggered.
- 2.9. The key elements of the re-opener process are illustrated in Table 1 below with further additional information below Table 1.

### **NZASP Contributions**

2.10. Where a potential NZASP project is substantially innovation related (for example, it could also be eligible for funding under either the Strategic Innovation Fund or Network Innovation Allowance), a contribution should be considered. We expect companies to follow a similar approach to that set out in the Strategic Innovation Fund governance document<sup>4</sup> in considering whether a contribution to the project should be provided:

- the default level of expected contribution is 10% for substantially innovative projects

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<sup>4</sup> <https://www.ofgem.gov.uk/publications/sif-governance-document>

- network licensees can justify higher or lower contributions as appropriate for a specific project, based on considerations such as levels of risk and financial benefit.

2.11. For example, network licensees may suggest a lower contribution where they do not expect to financially benefit from a project or a higher contribution to account for the extent of non-network benefits that the project has the potential to deliver.<sup>5</sup>

2.12. Contributions can be made from the network licensee or third parties involved in the project and can include benefits-in-kind.<sup>6</sup> This can include funding from government where there is a contractual commitment and the contribution is directly related to activities being funded by Ofgem.

2.13. In some cases, we may consider whether it is appropriate to confirm our expectations for the level of the contribution in the Pre-trigger Engagement Phase of the NZASP Re-opener Process, following engagement with the network licensee. Based on this, the network licensee should then confirm the contribution it proposes to make towards its project within its application.

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<sup>5</sup> See paragraph 4.15 of the SIF Governance Document.

<sup>6</sup> This includes any non-cash benefit (eg resources/services) of monetary value that are provided for the delivery of the project by project partners.

Table 1: The NZASP re-opener Process

<b>Pre-trigger Engagement Phase: exploring whether there is a needs case</b>	
<b>Step</b>	<b>Purpose</b>
Engagement	<p>Active engagement to understand the project need and establish a needs case, in principle:</p> <ul style="list-style-type: none"> <li>• What is being proposed;</li> <li>• The project cost;</li> <li>• The aim of the project and evidence that it fits into wider strategic goals;</li> <li>• Why it is appropriate for this to be funded by network consumers through this re-opener, and how the funding should be treated from a regulatory point of view; and</li> <li>• The timelines for the project including its anticipated length and the submission dates for the detailed assessment phase (see below).</li> </ul> <p>This Engagement Phase will be informed, and developed, over time through engagement with the relevant stakeholders, including network licensees and government.</p>
Information gathering	<p>A process managed by Ofgem to draw out the key information above and any additional information to help establish the needs case.</p> <p>Where appropriate, Ofgem will provide further guidance on structures and templates for this information.</p>
<b>Post-trigger Detailed Assessment Phase: after needs case, in principle, is established</b>	
<b>Step</b>	<b>Purpose</b>
Licensee application	<p>For funding to be provided under the NZASP re-opener, the network licensee will need to submit an application to us.</p> <p>Unless otherwise specified by us, this should include:</p> <ul style="list-style-type: none"> <li>• A full needs case;</li> <li>• Detailed cost information, including cost/benefit analysis, and the proposed regulatory treatment of the costs;</li> <li>• An engineering justification paper;</li> </ul>



	<ul style="list-style-type: none"> <li>• A policy justification paper, which explains why an adjustment to allowances is justified and how the project aligns with overall strategic aims; and</li> <li>• Any contributions towards the project.</li> </ul> <p>We may request that a specific proforma(s) is used for the application. We expect any specific proforma(s) to have been considered, and in some cases, developed through the 'engagement phase' above.</p> <p>As part of the 'engagement phase', we will work with network licensees to develop appropriate timelines for application submissions.</p> <p>The licensee application guidance provided above should be read in conjunction with the guidance provided in the RIIO-2 Re-opener Guidance and Application Requirements Document<sup>7</sup>.</p>
<p>Consultation</p>	<p>Based on the characteristics of the project we will determine whether a policy consultation is appropriate and the length of time.</p> <p>This is in addition to the required consultation on the proposed funding decision.</p>
<p>Funding decision</p>	<p>The Authority makes a funding decision and directs the relevant changes.</p> <p>This will include a decision on the regulatory treatment of approved funding. Further information on this is below this table.</p>

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<sup>7</sup>[https://www.ofgem.gov.uk/system/files/docs/2021/02/reopener\\_guidance\\_and\\_application\\_requirements\\_document.pdf](https://www.ofgem.gov.uk/system/files/docs/2021/02/reopener_guidance_and_application_requirements_document.pdf)

*How we will assess the information submitted through the Detailed Assessment Phase*

2.14. Under the Detailed Assessment Phase of the project, we will endeavour to take a proportionate approach to assessment to make quick decisions where this is appropriate. Some of the things we will consider are:

- The value of the work or project;
- The complexity of the work or project;
- How the work or project aligns with strategic policy aims; and
- Whether or not our funding decision will set a precedent for future projects.

2.15. Ofgem’s general approach to managing all RIIO-2 re-opener application assessments in a proportionate way is set out in a separate guidance document<sup>8</sup>. This document includes further information on how we will manage the applications pipeline and how we will assess applications in a proportionate way, including indicative timescales.

2.16. This document should be read in conjunction with this further guidance.

*Funding decision*

2.17. Throughout NZASP Re-opener Process, we will engage network licensees on the potential regulatory treatment of the approved funding and may require network licensees to adopt conditions in relation to a project in order for it to receive funding under this Re-opener.

2.18. Prior to a funding decision being made, we will consult on the proposed funding decision. This will include any draft conditions to hold licensees to account for specific project deliverables, such as evidence to be reported to Ofgem or milestones that may require Ofgem approval before the project can progress further.

2.19. Once the consultation is published, Ofgem will engage with the network licensee on the wording of the draft conditions and may make clarifications or amendments as a result of the

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<sup>8</sup> <https://www.ofgem.gov.uk/publications/riio-2-indicative-re-opener-application-assessment-process-working-document>

consultation. Prior to a funding decision being issued, the licensee should indicate, in writing, that it will comply with the conditions following any amendments made by Ofgem.

2.20. At the end of the project, Ofgem will expect a close-down report from the network licensee setting out how it has met the conditions and any instances of under or non-delivery. Under or non-delivery may be permissible subject to a well reasoned justification from the network licensee. The Licensee may also set out well reasoned justifications for the return of some contributions where the licensee has met all project conditions at a lower than expected cost, for example a material efficient underspend or halting a project early. Where Ofgem determines the network licensee has been unable to justify under or non-delivery, it may consider that some of the funding should be returned to consumers. In this case, Ofgem may adjust the funding awarded following the process provided in Special Condition 3.9.

2.21. As part of our funding decision we may also:

- Require network licensees to share knowledge in a way which is broadly consistent with the NIA and SIF mechanisms;
- Socialise approved funding across all consumers through issuing a direction under Special Condition 6.1 of the National Grid Gas Transporter licence.
- Set out how the value of any funding to be returned will be calculated.

2.22. We may consider whether further licence changes are needed to support different regulatory treatments under this re-opener in relation to each project, for example to:

- Direct a different split between upfront funding and longer-term fund (through the regulatory asset value);
- Apply the Totex Incentive Mechanism<sup>9</sup> to socialised costs; or
- Use a Price Control Deliverable.

2.23. If the licence is amended, we would expect to amend this governance document to provide further information on the regulatory treatment options under this re-opener.

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<sup>9</sup> As defined in Special Condition 1.1 of the Gas Transporter Licence