

**Reference**  
SGN LTS Futures Reopener

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Dear Duncan

**SGN LTS Futures Project**  
**Net Zero Pre-construction and small projects reopener consultation**

Cadent owns and operates four of the eight gas distribution networks in the UK. Our pipes carry gas to 11 million homes, schools, hospitals and businesses in the North West of England, the West Midlands, the East of England and North London. As an organisation at the centre of the UK's energy transition, we stand firmly behind the UK's commitment to deliver net zero by 2050.

We are playing a leading role alongside the other gas networks to demonstrate the gas grid's capability to deliver hydrogen to communities across the UK, to achieve net zero at least cost and with least disruption.

Thank you for the opportunity to respond to this consultation, which is the first use of the new RIIO-2 Net Zero pre-construction and small projects reopener. The efficient and flexible deployment of this and other net zero uncertainty mechanisms will be key to enable the timely delivery of vital net zero projects.

On the attached pages you will find Cadent's response to the consultation questions. Please get in touch if you would like us to expand on any of the points made in this submission.

A handwritten signature in blue ink that reads 'S. Easterbrook'.

**Stuart Easterbrook**  
Head of Net Zero Energy Frameworks, Cadent



## **SGN LTS Futures Project: Net Zero pre-construction and small projects reopener consultation**

### **Question 1: Do you agree that this project should be approved, and at the value proposed?**

We are fully supportive of this application for funding of this critical net zero project, and strongly support Ofgem's minded to decision to fully fund this initiative.

We were surprised that the consultation did not include the total funding that was requested. This would have been useful to fully set the context for Ofgem's minded to decision.

### **Question 2: Do you agree with our assessment of and additional requirements for SGN's project plan?**

We are broadly supportive of the deliverables set out in the Project Plan. We would, however, expect any additional reporting or audit requirements to be recognised in the funding provided for this project, such as the desire for 3<sup>rd</sup> party validation.

We will continue to work closely with our colleagues in SGN and the other gas networks on this and other related projects, to ensure that all our technical, commercial and regulatory initiatives are effectively coordinated to ensure best use of limited resources, and to avoid unhelpful duplication.

### **Question 3: Do you agree with our proposals on how we will hold SGN to account for the project deliverables?**

We are supportive of the approach taken by Ofgem. With this type of project, a degree of pragmatism will be required to recognise the level of inherent uncertainty.

### **Question 4: Do you have any views on the appropriate funding approach for this project?**

Whilst we do not object to the proposed funding approach, we do not believe it is necessarily in the best interest of consumers to always pass through such costs as regulatory 'fast money', with a much larger consumer bill impact; whilst ruling out the use of a RAB treatment for all or some of the expenditure. We have repeatedly highlighted our view that there is a need to ensure that the funding mechanisms associated with the RIIO-2 re-openers are flexible and allow RAB recovery. There has, however, been a reluctance seemingly to accept this and find the means of achieving it. It is disappointing to see the lack of flexibility in the RIIO-2 mechanisms being used as partial justification for the proposed approach. We urge Ofgem to consider how they can enable the deployment of RAB funding mechanism from UK consumers as a matter of urgency – even if this may require new powers. It is inevitable that a larger net-zero project will require such an approach very soon, and the lack of flexibility could present a barrier to progress.

We note there is no clarity provided in the consultation on how cost overruns or under-recovery is dealt with. There is value in addressing this for this and future projects, with symmetrical incentives such as the Totex Incentive Mechanism providing a potential route to manage this. Lack of certainty on how cost variations should be managed could create a future barrier for net zero projects. A well thought through mechanism can create an incentive to deliver efficiently whilst not delaying a project where reasonable cost overruns are being experienced.

Cost variations may also be driven by inflationary factors outside of a network's control and the importance of Real Price Effects and inflation needs to be considered to ensure project viability in the current and future market. Market conditions post Brexit and post pandemic are very different to recent history and we note that Totex in RIIO-2 is index linked with a true up process. Such protections should be considered for this and other re-openers.

Further clarity would also be welcomed regarding how the Licensee contribution will be set i.e. is it a percentage of forecast costs, or actual costs, and how is this managed and phased through the lifetime of the project. A final reconciliation step may be required.

### **Question 5: Do you agree with our assessment of SGN's proposed level of contribution and treatment of benefits in kind?**

We do not agree that this is an innovation project and therefore subject to a Licensee contribution. It is a net zero initiative, and the funding for this type of project has always been defined



separately from the suite of innovation support mechanisms in RIIO-2. This re-opener is part of a range of Net Zero mechanisms including the Net Zero and Re-opener Development Fund use it or lose it allowance and the Net Zero re-opener – where no contributions are required.

The policy and intent of the Net Zero re-openers was not as additional innovation mechanism. Instead, in the case of the gas networks, they were intended to provide agile funding mechanisms to support hydrogen readiness rather than companies including speculative costs for this work in their base plans. Furthermore, the delivery of net zero is a legislative requirement for the UK, not an optional commercial opportunity for networks to explore.

This principle and intent for agile net zero funding would be broken by introducing contributions for net zero supporting mechanisms, so it is not appropriate to read across innovation policy on Licensee contributions. If Ofgem has specific concerns that the scope of work progressed through these re-openers could extend to include innovation, or largely innovation-related projects, then they could introduce a mechanism to enable NIA/SIF style contributions.

If a general policy decision is being made by Ofgem to require a significant contribution from a network Licensee toward net-zero projects, we believe it should be subject to a separate consultation process. This should cover *both* gas and electricity networks, and should clearly and consistently define what is innovation and what is not. It should also establish the default funding approaches for different types or sizes of projects, and how contributions for each class of project are justified and the level determined.

Consistency is equally as important as clarity: for example, if net zero enabling gas projects are subject to a network contribution to the feasibility, design or construction costs, then we would expect the same to apply to comparable electricity net zero projects. Inconsistency would de facto provide for greater returns in one sector over the other and therefore inhibit a whole system approach to net zero, which would in turn result in a lack of protection of gas and electricity consumers.

Should a contribution be required, we welcome the type of flexibility shown by Ofgem in terms of the use of benefits in kind within network contributions.

## **General feedback**

### **Question 1: Do you have any comments about the overall process of this consultation?**

This is the first use of a RIIO-2 net zero reopener, and we appreciate there will be an element of discovery as all parties become more familiar with the process, as well as the solutions available to resolve the inevitable issues that will arise. Pragmatism and flexibility will be of great value, as well as transparency and visibility.

One area that may need to be considered in future is the notification of a re-opener trigger. In this case, we are not aware of any formal notification, which is less of an issue when the trigger criteria have been met, such as in this situation, as transparency can be provided in the re-opener consultation. However, if Ofgem do not believe the trigger criteria have been met, then the situation and visibility is less clear. Additional notifications of need case submission and trigger decisions could be helpful to cover all potential outcomes.