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Dear Duncan,

SGN Local Transmission System (LTS) Futures Project Consultation

We welcome the opportunity to respond to the above consultation. This response is provided on behalf of National Grid Gas plc (NGG), and I confirm that this response can be published on Ofgem's website.

Please find below our comments to the specific questions raised in the consultation document.

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

We agree that this project should be approved as it is part of a complimentary suite of projects all working towards a transition to a hydrogen future. Included in this suite of projects are some key strategic projects such as Project Union, H100, and H21, which will provide an evidence base to the Government on the long-term role of hydrogen.

We are committed to working closely and collaboratively on shared learning outcomes between the FutureGrid and LTS Programmes and look forward to working with SGN for the delivery of this project.

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

We believe that the project plan is appropriate and note that we have made our sufficient contributions through the Technical Advisory Group set up by SGN.

We support Ofgem's view to further develop a critical path that makes clear significant external dependencies such as approvals etc.

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

The deliverables set out within the consultation document appear to be relevant and appropriate. We welcome the addition of Appendix 1 in the consultation which sets out clear expectations of how a successful delivery of the project can be achieved as well as specific evidence requirements.

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

We note Ofgem's proposal to fully recover costs through Gas Transmission charges, with funding distributed to SGN in a manner similar to the approach adopted in the Strategic Innovation Fund (SIF).

This has the effect of socialising costs more broadly across gas network users than SGN's original proposal, with less targeted specifically at SGN's direct customer base. We accept Ofgem's logic for this preference whilst Government policy on Hydrogen investment evolves, however please see our comments regarding compulsory contributions in our answer to consultation question 5 below.

We would make the following observations around the innovation style funding approach:

- Costs essentially treated as all “fast funded” with all investment being recovered in the RIIO-2 period
- In the absence of firm policy and market conditions for Hydrogen at this stage, the approach avoids future cost stranding risks
- The approach is simple and transparent without adjustment to RIIO-2 framework parameters
- The approach allocates costs to all gas network users based on the NTS Charging Methodology contained in the Uniform Network Code
 - Accepting the current stage of policy development for Hydrogen, we recognise that this approach will not be durable in the long term
 - Once policy signals support it, it may be that a totex approach to investment recovery may be fully or partly appropriate depending on the nature of the project assessed
 - We anticipate that for RIIO-3, specific regulatory parameters for Hydrogen will need to be developed to the extent that these would necessarily differ to those applied to the methane network

To ensure the smooth functioning of this, and future project decisions, we will continue to work with Ofgem to ensure that distributions to funded parties and recoveries through charges are best aligned. For SIF, we have collaborated with Ofgem and Innovate UK to develop a periodic forecasting approach with optimised project decision and funding direction timelines that are aligned as far as possible to the Annual Iteration Process and charge setting processes. We foresee that a similar style of approach would be beneficial to future NZASP decisions.

To ensure the viability of the project in the current and future market, Ofgem's project direction should provide for the treatment of inflation and real price effects (RPEs). The importance of this is underlined by the volatility in market conditions we observe post Brexit, and the Covid-19 pandemic. The Net Zero Pre-Construction Work and Small Net Zero Projects Re-opener pass through term is excluded from the mechanised approach for RPEs applied elsewhere to baseline totex allowances. Furthermore, the Price Control Financial Model (PCFM) requires financial inputs in 2018/19 prices, and whilst these would be uplifted to nominal equivalents for the purposes of revenue recovery in the Gas Transmission price control, it is important that funding distributions to SGN are made in parity. To deal with this, Ofgem could issue its project direction on a forecast nominal basis using forecast indices for RPEs and inflation per the current version of the PCFM, and then seek to true these up to the actual equivalents on project completion.

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.

Consistent with our response to Ofgem's statutory consultation on changes to the Gas Transporter Licence from December 2021, we note that the requirement for compulsory contribution on NZASP was not signalled as part of the RIIO-2 Final Determinations, making this a retrospective change. There would be a benefit from a wider policy consultation across all stakeholders to further explore the appropriateness of this approach.

Lifting provisions from the SIF would imply that all NZASP projects are of an innovation nature which will not be the case in all circumstances.

Furthermore, Ofgem's approach to funding seems to be more driven by the current stage of policy development than the nature of projects. We are sympathetic to this logic, but this should not extend to a de facto assertion that all projects under NZASP are, and should be treated as, pure innovation projects.

Our view is that projects put forward under NZASP should be considered on a case-by-case basis and taking into account the specific nature of the project under assessment. This would then allow

projects to be assessed based on prevailing policy conditions as opposed to setting default rules for all projects that fall under the NZASP mechanism.

We would like to thank Ofgem for the opportunity to feedback on this consultation and would be open to further dialogue on any of our comments highlighted within this response. For queries in relation to our consultation response please contact raveena.virk@nationalgrid.com

Yours, sincerely,

A handwritten signature in black ink, appearing to read 'A.T. Nixon', with a horizontal line extending from the end.

Tony Nixon

Regulation Director