

LTS Futures Project Direction

On the 10th March 2022, Ofgem released their decision to fund the LTS Futures programme in full under the Net Zero Pre-construction Work and Small Net Zero Projects Re-opener (NZASP). Having reviewed the decision documentation, SGN are pleased to inform Ofgem that we in principle accept the direction for the LTS Futures Programme although we ask that Ofgem reviews its decision regarding the application of CPIH and RPE indexation for the reasons set out below.

Within Schedule 1: Proposed direction to SGN, Annex 2 illustrates the Project Deliverables that SGN must complete and subsequently disseminate with expected dates of submission for deliverables. We would like to make Ofgem aware of two amendments required to the table with Annex 2, shown below.

- **Deliverable 2**-Recommendation on whether to progress modifications to Grangemouth to Granton pipeline and construct H2 supply infrastructure, including supporting evidence for Ofgem decision. Expected submission date to be amended to 31st March 2023 as per project plan sent on the 28th February 2022.
- **Deliverable 3**-Recommendation on whether to progress to live trial, including supporting evidence, for Ofgem decision. Expected submission date to be amended to 1st April 2024 as per project plan sent on 28th February 2022.

It is worth noting that the following dates will be when SGN receive a decision on the deliverable. Subsequent submission of evidence to Ofgem will occur a minimum of 2 weeks after the expected submission date to allow SGN to compile information into a workable format for Ofgem review. Below illustrates the Annex 2 table with amendments made to Deliverables 2 and 3.

Reporting	Expected submission date
1. a) Revised stakeholder engagement plan and knowledge dissemination plan. b) Hydrogen ownership proposal, for Ofgem decision.	30 Jun 2022
2. Recommendation on whether to progress modifications to Grangemouth to Granton pipeline and construct H2 supply infrastructure, including supporting evidence, for Ofgem decision.	31 st March 2022 As per project plan. Deliverable submission to Ofgem a minimum of two weeks after 31 st March 2022.
3. Recommendation on whether to progress to live trial, including supporting evidence, for Ofgem decision.	1 st April 2024 as per project plan. Deliverable submission to Ofgem a minimum of two weeks after 1 st April 2024.
4. Confirmation that the project has been completed	31 Mar 2025
5. Closedown report. This report should include the following: a) Confirmation that the project has successfully delivered a blueprint for future LTS repurposing and uprating projects. b) Confirmation that project learnings have been shared in accordance with the knowledge dissemination plan. c) Confirmation that SGN have submitted all necessary information to the HSE to demonstrate they have fully, or partially, closed the 45 evidence gaps listed in their submission, and that the HSE have raised no objections in response. d) Any further requirements set out in the Re-opener Governance Document.	30 Jun 2025

CPIH Indexation

As we discussed at a joint meeting between Ofgem, NGGT and SGN on the 22nd March, the NGGT price control financial model (PCFM) would automatically apply an adjustment for CPIH to the values that are updated as a result the LTS futures project direction. This will create a mismatch between the funds NGGT collects and the funds NGGT are directed to disburse (which as they currently stand are not indexed according to out-turn CPIH). As we discussed during the meeting, the easiest manner in which to rectify this mismatch is to enable the funding direction to be adjusted to accommodate CPIH indexation in line with the NGGT PCFM. This should be resolved by representing costs in 18/19 prices and then indexing funding by CPIH on an annual basis with a final true up post project completion. This would then create consistency with the receipt of money through the tariffs and the funding received by SGN.

RPE application

Additional discussions were had on RPEs, given the Ukraine situation and resulting increase in steel prices and subsequent price volatility. The project was submitted based on our best estimate of costs as at April 2021 and was priced at nominal values, therefore no RPE adjustment was made for the 21/22 period and beyond in the core funding request, rather we proposed a indexation as per other regulatory totex allowances. Since the submission, the steel market has been fundamentally altered with the withdrawal of a large proportion of Ukrainian and Russian supply from the market as a result of the conflict in a major steel producing region. This has historically accounted for approximately a third of European supply and has increased prices by over 40% since 1st April 2021, the basis of the submission.

With 13% of the project costs relating directly to steel materials the steel price increase in isolation could introduce an additional cost of £1.8 m (the analysis to support this is appended to this paper). We anticipate that this is only one component of cost pressures arising from the conflict in Ukraine and it will take time to a fuller understanding of the impact on other commodity costs.

As a result of these unprecedented level of price increase and supply chain disruption, we request that Ofgem re-evaluates the application of RPEs to the reopeners such as LTS Futures. Until there is clarity and time for the supply chain to respond to the Ukrainian crisis, there will continue to be high levels of volatility and risk around the pricing of projects. It is our view that these risks are covered by an appropriate index, as with the rest of the totex settlement, rather than priced into the project at the outset, and that this will protect consumers and project delivery as a result.

In the proposed direction Ofgem stated that due to the short time frame of the project that risk was substantially lower than for business plan totex forecasts, the Ukrainian situation demonstrates that this is can not be assumed. In the proposed direction Ofgem also drew a link to between RPEs and ongoing efficiency, this is not a link that we would recognise as having an economic basis.

It is important that these projects are structured appropriately to ensure deliverability. Given the high capital cost component, the extended time period of the project and the unprecedented volatility, as a direct result of the Ukraine crisis, our recommendation is for the inclusion of RPEs. We think this can flow through the NGGT PCFM model in a similar manner to CPIH.