

## Schedule 1: Direction to SGN

To:

**Scotland Gas Networks plc ('SGN' or 'Licensee')**

### **Direction under Part C of Special Condition 3.9. (Net Zero Pre-construction Work and Small Net Zero Projects Re-opener (NZPt))**

#### General

1. SGN is the holder of a licence granted or treated as granted under section 7 of the Gas Act ('the Act').
2. On 31 October 2021, SGN submitted a Re-opener application<sup>1</sup> in respect of the needs case, option selection and forecast costs of a project to demonstrate whether the Local Transmission System (LTS) can be repurposed to carry hydrogen (LTS Futures or the "Project"). On 5 January 2022 we consulted on the needs case and efficient costs for the Project<sup>2</sup>. Having considered the consultation responses, on 10 March 2022, we published our decision and approved £29.94m in nominal values in funding for the project<sup>3</sup>.
3. This direction is issued pursuant to Part C of Special Condition 3.9. (Net Zero Pre-construction Work and Small Net Zero Projects Re-opener (NZPt)). It sets out the approved funding, the adjustment to the value of NGGT's NZPSt term and the Regulatory Years to which that adjustment relates, as well as the conditions to be met by SGN in relation to the Project. It is issued alongside a direction to NGGT, setting out the necessary amendment to the value of the NZPSt term in Appendix 2 of Special Condition 6.1 Part F of NGGT's licence.
4. In accordance with Part C of Special Condition 3.9., the Gas and Electricity Markets Authority ("the Authority") published on its website the text of the proposed direction and stated that representations must be made on or before 24 March 2022.
5. We received two responses and have placed all non-confidential responses on our website. Having considered those responses, we have decided to proceed with making this direction.
6. NGGT and SGN both asked for clarification on the treatment of CPIH inflation in the funding to be collected and passed on to SGN. They noted that the direction specified these in both nominal and real 18-19 values, but that the value of these would diverge over time.

---

<sup>1</sup> <https://www.ofgem.gov.uk/sites/default/files/2022-01/Annex%20-%20SGN%20NZASP%20Application%20-%20Redacted.pdf>

<sup>2</sup> Available at <https://www.ofgem.gov.uk/publications/sgn-local-transmission-system-lts-futures-project>

<sup>3</sup> Available at <https://www.ofgem.gov.uk/publications/sgn-lts-futures-project-decision>

7. We agree that clarification is required on this point. In line with standard policy for RIIO-2 re-openers, the level of consumer funding for the Project will be set in real 18-19 values, to allow for changes in the level of CPIH inflation. However, as set out above, the consumer funding will take account of outturn inflation. Therefore, we have amended paragraphs 12 and 13 to make this clear. We have also added a new paragraph 15 to include a final reconciliation to take account of outturn inflation throughout the project.
8. Further, SGN requested revisions to the submission dates for parts 2 and 3 of the reporting requirements in Annex 2 of this direction. The revisions would align the date to those included in their submission, and would include an additional 2 weeks to compile the submission in each case.
9. We agree with SGN's proposal and have amended the submission dates as suggested.
10. SGN also submitted new evidence in respect of Real Price Effect (RPE)<sup>4</sup> impacts, noting that steel prices have risen by 40% since the start of the war in Ukraine, and that this could result in a £1.8m increase in project costs.
11. We have considered SGN's evidence but have decided not to make any changes to this direction. We think this is consistent with RIIO-2 policy on re-openers, and with our previous treatment of events that have disrupted commodity or financial markets. We also note that the majority of the project's steel costs will be incurred in 2023-24, and the level of steel prices for that period remains highly uncertain. We therefore do not think that amending the direction in this way would be in the interest of consumers.

#### Approved funding for the Project

12. The approved amount is **£29.94m**, in current nominal values, based on the forecasts for inflation set out in the GT2 Price Control Financial Model (PCFM) published on 4 February 2022<sup>5</sup>.
13. The total amount of £29.94m comprises a £2.99m contribution from SGN, and £26.9m in consumer funding. SGN's contribution, consisting of both cash and benefits in kind, is a fixed nominal value, and will not vary with inflation. The consumer funding is set in real 18-19 values. Based on the current PCFM inflation forecasts, the nominal value of £26.94m equates to £23.77m in 18-19 values. This total of £23.77m will be recovered by NGGT, through NTS Transportation Owner Charges<sup>6</sup>, and transferred to SGN. Annex 1 sets out the amounts to be recovered in each Regulatory Year and attributed to the Licensee.
14. The timing of the revenue transfer between NGGT and the SGN must occur in accordance with Special Condition 6.1.13 of NGGT's Licence. SGN is responsible for notifying NGGT of the bank account details to which transfers must be made, using the template provided in Annex 3 to this direction.

---

<sup>4</sup> As defined in Appendix 1 to the GD2 Price Control Financial Handbook

<sup>5</sup> Available at <https://www.ofgem.gov.uk/publications/gt2-price-control-financial-model>

<sup>6</sup> As defined in Special Condition 1.1.15 of National Grid Gas' Gas Transporter Licence

15. Following the end of the project on 31 March 2025, NGGT must confirm to SGN the cumulative nominal value of consumer funding, based on outturn inflation to the end of financial year 2024/25. NGGT and SGN must then carry out a reconciliation of this value against the amounts distributed to SGN by NGGT throughout the project, with any difference settled as an additional funding distribution from NGGT, or a funding return from SGN accordingly.

Project Funding Conditions

16. The Licensee must abide by the following conditions in undertaking the Project. It must:

- (i) undertake the Project in accordance with the description set out in Section 3 of their Re-opener application<sup>7</sup>;
- (ii) complete all the deliverables set out in Annex 2 of this Direction; and
- (iii) share the learnings from the Project as set out in the knowledge dissemination plan referred to in deliverable 1 a) of Annex 2 to this Direction.

Notifications and other project deliverables

17. SGN must inform the Authority promptly in writing of any material event or circumstance likely to affect its ability to deliver the Project as set out in its submission.

18. At the end of the Project, SGN must submit a close-down report to the Authority setting out how it has completed the deliverables set out in Annex 2 below.

19. If the Licensee fails to comply with a condition imposed by this Direction, the Authority will make use of this report in considering whether any funding should be returned to consumers, pursuant to Special Condition 3.9.12 of SGN's licence. .

*NOW THEREFORE,*

20. The Authority, pursuant to the provisions of Special Condition 3.9 and the Re-opener Governance Document, issues this Direction to SGN.

21. This Direction constitutes notice of reasons for the Authority's decision pursuant to section 38A (Reasons for decisions) of the Gas Act 1986.



Duly authorised on behalf of the Gas and Electricity Markets Authority

6 April 2022

---

<sup>7</sup> Available at <https://www.ofgem.gov.uk/sites/default/files/2022-01/Annex%20-%20SGN%20NZASP%20Application%20-%20Redacted.pdf>

### **Annex 1: Funding value**

This annex sets out the amendments to be made to NGGT’s licence. The figures below are expressed in 18/19 values.

### **Special Condition 6.1 Part F Appendix 2**

Payments to Distribution Networks for Net Zero Pre-construction Work and Small Net Zero Projects (£m)

<b>Distribution Network/Regulatory Year</b>	<b>2021/22</b>	<b>2022/23</b>	<b>2023/24</b>	<b>2024/25</b>	<b>2025/26</b>	<b>Total</b>
SGN plc	0.00	13.36	7.92	2.50	0.00	23.77

## Annex 2: Project Deliverables

This annex sets out our requirements that SGN will be held to account for delivering through this project. Should SGN be unable to meet these deadlines, they must notify Ofgem of this at least two weeks beforehand, setting out the reasons for the delay and a revised submission date.

Reporting	Expected submission date
1. <ul style="list-style-type: none"> <li>a) Revised stakeholder engagement plan and knowledge dissemination plan.</li> <li>b) Hydrogen ownership proposal, for Ofgem decision.</li> </ul>	30 Jun 2022
2. Recommendation on whether to progress modifications to Grangemouth to Granton pipeline and construct H <sub>2</sub> supply infrastructure, including supporting evidence, for Ofgem decision.	14 Apr 2023
3. Recommendation on whether to progress to live trial, including supporting evidence, for Ofgem decision.	15 Apr 2024
4. Confirmation that the project has been completed	31 Mar 2025
5. Closedown report. This report should include the following: <ul style="list-style-type: none"> <li>a) Confirmation that the project has successfully delivered a blueprint for future LTS repurposing and uprating projects.</li> <li>b) Confirmation that project learnings have been shared in accordance with the knowledge dissemination plan.</li> <li>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.</li> <li>d) Any further requirements set out in the Re-opener Governance Document.</li> </ul>	30 Jun 2025

**ANNEX 3: TEMPLATE OF BANK ACCOUNT DETAILS TO BE PROVIDED TO NGGT**

**\*REDACTED\***