

To:

**Cadent Gas Limited
Northern Gas Networks Limited
Scotland Gas Networks plc
Southern Gas Networks plc
Wales and West Utilities Limited**

**Gas Act 1986
Section 23(2)**

Notice of statutory consultation on a proposal to modify the Special Conditions of the Gas Transporter licence held by the licensees listed above

1. Each of the licensees to whom this document is addressed is the holder of a Gas Transporter Licence ('the Licence') granted or treated as granted under section 7 of the Gas Act 1986 ('the Act').
2. The Gas and Electricity Markets Authority ('the Authority') proposes to modify the special conditions ('SpCs') of the Licence by amending SpC 3.20 (Diversions and Loss of Development Claims Re-opener (DIVt)).
3. The purpose of this re-opener mechanism is to allow licensees to recover efficient costs relating to diverting or securing pipelines due to soil erosion or unavoidable accommodation of third-party works. This is appropriate as both soil erosion and third-party works are usually outside of the licensee's control, and evidence indicating that work is required to protect network assets from their effects is often not available when the price control is set. The re-opener allows for the timely work to divert or secure pipelines as and when there is evidence that work is required, and benefits consumers as it avoids the need for up front allowances that may turn out to not be needed, or to be insufficient for the volume of work required.
4. The current licence condition drafting limits licensees to recovery of efficient costs only in cases where:
 - a. the work is needed due to the impact of soil erosion, and
 - b. the efficient solution is asset diversion.However, these licence limitations mean that the scope of the re-opener is too restrictive to deliver the consumer benefits that it was originally intended to deliver.
5. Firstly, there are environmental factors, other than soil erosion, that are similarly outside of the licensee's control and would necessitate similar mitigation measures, such as a landslip due to an extreme weather event. Where works are necessary to maintain a

resilient network, for licensees to comply with their statutory obligation to ensure the safety of their networks, or to reduce risk of additional costs to consumers in the future, then they should be funded regardless of the necessitating factor.

6. Secondly, in some cases there may be alternative solutions to asset diversions that deliver the same benefits to consumers but at lower lifetime cost. At present the current licence drafting does not permit licensees to recover efficient costs associated with any alternative solutions, and therefore incentivises them to either undertake the more costly diversion, or to defer necessary works to later date.
7. Therefore, in order to align the scope of the Diversions and Loss of Development Claims Re-opener with the original policy intent, we are making changes to expand the licence scope to permit the recovery of efficient costs:
 - a. for works that are necessary due to environment factors, in addition to soil erosion, that are outside of the licensee's control; and
 - b. for alternative solutions with lower lifetime costs than diversions.
8. The full text of the proposed modifications to SpC 3.20 are set out in Annex 1, with the new text to be added shown double underscored.
9. A copy of the proposed modifications and other documents referred to in this Notice have been published on our website (www.ofgem.gov.uk). Alternatively, they are available from foi@ofgem.gov.uk.
10. Any representations with respect to the proposed licence modifications must be made on or before 23 April 2024 to: Catherine Warrilow, Office of Gas and Electricity Markets, 10 South Colonnade, Canary Wharf, London, E14 4PU or by email to catherine.warrilow@ofgem.gov.uk.
11. We normally publish all responses on our website. However, if you do not wish your response to be made public then please mark it as not for publication and provide an explanation of why it should be treated as confidential. We prefer to receive responses in an electronic form so they can be placed easily on our website.
12. If we decide to make the proposed modifications, they will take effect not less than 56 days after the decision is published.

Nathan Macwhinnie

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Nathan Macwhinnie
Duly authorised on behalf of the
Gas and Electricity Markets Authority

26 March 2024

Annex 1: Modifications to 3.20.2, 3.20.4, 3.20.6 and 3.20.7 in Special Condition 3.20 of the gas transporter licence held by Cadent Gas Limited, Northern Gas Networks Limited, Scotland Gas Networks plc, Southern Gas Networks plc, Wales and West Utilities Limited.

(New text is double underscored and text removed is struck through)

Special Condition 3.20 Diversions and Loss of Development Claims policy Re-opener (DIV_t)

Introduction

- 3.20.1 The purpose of this condition is to calculate the term DIV_t (the Diversions policy Re-opener term). This contributes to the calculation of the Totex Allowance.
- 3.20.2 The effect of this condition is to establish a Re-opener triggered by the licensee where there are material additional Diversion Costs, reasonable alternative solutions that avoid Diversion Costs, Loss of Development Claims or costs of rectifying or mitigating damage to Network Assets due to adverse environmental factors beyond the control of the licensee ~~from soil erosion~~.
- 3.20.3 This condition also explains the process the Authority will follow when directing any changes as a result of the Re-opener.

Part A: What is the scope of this Re-opener?

- 3.20.4 The licensee may apply to the Authority for a direction adjusting the value of the DIV_t term for any Regulatory Year during the Price Control Period in relation to additional:
- (a) Diversion Costs or the cost of reasonable alternative solutions that avoid Diversion Costs;
 - (b) Loss of Development Claims; or
 - (c) costs of diverting gas assets due to adverse environmental factors.

Part B: When to make an application

- 3.20.5 The licensee may only make an application under paragraph 3.20.4 Between 25 January 2024 and 31 January 2024, and during such later periods as the Authority may direct.

Part C: How to make an application

- 3.20.6 An application under paragraph 3.20.4 must be made in writing to the Authority and:
- (a) specify the Diversion Costs, the cost of reasonable alternative solutions to avoid Diversion Costs, Loss of Development Claims or costs of rectifying damage or mitigating the risk of damage to Network Assets due to adverse environmental factors beyond the control of the licensee ~~from soil erosion~~ that have led to the application;

- (b) set out the adjustments to the value of the DIV_t term that the licensee is requesting and the Regulatory Years to which that adjustment relates;
- (c) explain the basis of the licensee's calculation of the proposed adjustments to the value of the DIV_t term;
- (d) if the application relates to Diversion Costs, include engineering justification statements that the Diversion Costs, are efficient and unavoidable;
- (e) if the application relates to reasonable alternative solutions to avoid Diversion Costs, these must be at lower lifetime cost than a Diversion and provide the equivalent consumer benefits as a Diversion would;
- (f) if the application relates to Loss of Development Claims, demonstrate that reasonable challenge has been made to the basis for, and quantum, of any Loss of Development Claim; and
- (g) include such detailed supporting evidence, including Improvement Plans, risk mitigation approaches, cost benefit analysis and impact assessments, as is reasonable in the circumstances.

3.20.7 An application under paragraph 3.20.4 must:

- (a) Be confined to Diversion Costs, the cost of reasonable alternative solutions to avoid Diversion Costs, Loss of Development Claims or costs of rectifying damage or mitigating the risk of damage to Network Assets due to adverse environmental factors beyond the control of the licensee ~~from soil erosion~~ that were incurred or are expected to be incurred on or after 1 April 2021;
- (b) take account of any allowed expenditure, which can be avoided as a result of the change; and
- (c) relate to costs incurred or expected to be incurred that exceed the Materiality Threshold.

Part D: What process will the Authority follow in making a direction?

3.20.8 Before making a direction under paragraph 3.20.4 the Authority will publish on the Authority's Website:

- (a) the text of the proposed direction;
- (b) the reasons for the proposed direction; and
- (c) a period during which representations may be made on the proposed direction, which will not be less than 28 days.

3.20.9 The direction will set out any adjustments to the value of the DIV_t term and the Regulatory Years to which that adjustment relates.