



Catherine Warrilow
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Canary Wharf,
London,
E14 4PU

24th February 2025

Dear Catherine,

RIO-2 NZASP Reopener Draft Determinations: NGN Birkshall Rationalisation and Relocation Works Project

Thank you for the opportunity to respond to Ofgem's consultation regarding its Draft Determination for Northern Gas Networks' (NGN) Birkshall Rationalisation and Relocation Works Project. This response represents the views of Northern Gas Networks (NGN) to the questions in your consultation.

We are supportive of the use of Hydrogen to help the UK's decarbonisation journey and consider that network augmentation and asset relocation to maximise the value of projects funded via the UK Government's Hydrogen Allocation Round is an essential step to support a cost effective and efficient delivery of the UK net zero targets with minimum disruption to consumers.

We have carefully considered your consultation document and provide responses to the consultation questions below. In addition, we confirm that we will continue to work closely with Ofgem and interested parties throughout project delivery to ensure that learning and innovation can be shared across sectors.

We collectively support the minded to position on the Birkshall Rationalisation and Relocation Works Project, subject to Ofgem's consideration of our response to the questions overleaf.



Consultation questions

Question 1: do you agree with our assessment of NGN's application under the NZASP Reopener?

Yes, we agree with the needs case and optioneering assessment, but we disagree with Ofgem's assessment of draft allowances.

Needs Case

This project is a key enabler to Bradford Low Carbon Hydrogen (BLCH) project that has been awarded a Low Carbon Hydrogen Agreement via the UK Governments Hydrogen Allocation Round (HAR1) Process. We support the decision to fund the asset rationalisation and relocation, as the project is additional work that could not reasonably have been forecast or included within funding when RIIO-2 plans were finalised in December 2020.

Successful delivery of the project will facilitate c25% additional space to deliver the BLCH project and maximise hydrogen production. We agree with Ofgem's assessment that this is clearly a Net Zero facilitation project, as defined by Ofgem's NZASP guidance.

Optioneering Assessment

We agree with Ofgem's assessment that we have undertaken the appropriate optioneering to address the need case.

Cost assessment

NGN has set the benchmark for efficient costs for gas distribution networks since 2005 and has a demonstrable track record of delivering against an efficient cost base whilst also meeting output targets. The same rigor and transparency that has delivered the efficiency frontier has been applied to the cost assessment of this project by NGN and we therefore strongly believe our submitted costs represent efficient project costs. Ofgem specifically note the comparison to previous similar projects in its "minded to" decision at paragraph 3.8 for the main works that demonstrates this.

We disagree with Ofgem's decision to reduce the risk allowance that NGN has applied to the main works category. We acknowledge the precedent that is referenced by Ofgem, however, we argue that non-operational IT has a greater degree of certainty than the asset rationalisation and relocation which involves interaction with medium and high pressure assets which are naturally more riskier than fixed operational IT. Additionally, we note and have previously advised Ofgem of the supply chain risk with ordering long lead items for this project and factors outside of NGN's control that could impact timescales and deliverability which leads to increased cost. We consider that the risk threshold should remain at 11.5%.

We disagree with Ofgem's assessment of direct costs and the removal of supposed business as usual activities. This project is in addition to delivering business as usual and additional central activities will be required to deliver the project to time and scale. As outlined above, NGN has operated at efficiency frontier since 2005 and at RIIO-2 Final Determination was assessed as the most efficient network. This led to NGN being awarded

a challenging cost base which was 7% below what Ofgem has assessed to be the efficiency frontier. We maintain that direct costs for central functions should be included within the funding decision to avoid further cost pressure on project delivery and scope. NGN has included only necessary efficient costs in its assessment that are marginal and following Ofgem's Application of the TIM impact adjustment as assessed at 3.17-3.19 are reasonable to allow project delivery. We consider that NGN's direct costs should be awarded in full and full project costs are subject to the TIM impact adjustment to determine the final allowance.

Question 2. Do you agree that costs should be socialised across only NGN consumers rather than all Great Britain consumers?

Yes.

Whilst we consider that successful delivery of the BLCH Project, funded under HAR1 will deliver enduring benefit and value for the wider UK and its ambition to meet binding net zero targets by 2050 we acknowledge that the core network funding for NGN is an asset rationalisation and relocation of an existing an NGN network asset. In the normal course of regulatory funding this will be covered through a company's TOTEX allowance, and we see that this an appropriate way to treat funding of this project.

Question 3. Do you agree with the 10% company contribution rate, and our proposed Totex Incentive Mechanism (TIM) adjustment?

We do agree with the 10% contribution rate, and in principle we understand the TIM adjustment and Ofgem's intention and do not object to its inclusion. However, there are two clarifications we would like to make.

Firstly, we have identified an error in the calculation based on the numbers and formula that Ofgem has provided. Applying the formula outlined in paragraph 3.18 and 3.19 to Ofgem's "minded to" position on costs, we calculate that the allowance should be £3.65m not £3.61m. It appears that the TIM impact adjustment outlined in Table 2 should be -0.48 and not -0.52. This would align the value derived by the formula and information in table below:

18/19 prices	NGN Submitted	Ofgem Adj.	Ofgem DD	Correct Allowance
Main Works	4.08	0	4.08	4.08
Risk Allowance	0.47	-0.16	0.31	0.31
NGN Direct Costs	0.69	-0.49	0.2	0.2
Efficient project Costs	5.24	-0.65	4.59	4.59
NGN Contribution	-0.52	0.06	-0.46	-0.46
TIM Impact Adjustment		-0.52	-0.52	-0.48
	4.72		3.61	3.65

Formula = 4.59 – (0.46/49%) = £3.65m

Notwithstanding, we maintain that NGN has submitted efficient costs which should be funded.

Secondly, the BLCH project has confirmed they will cover the 10% contribution towards the project, not NGN. This means the methodology outlined by Ofgem does not work. Please see the below table for details. This table assumes that the risk allowance and direct costs are added back into our submission as outlined in our response to Q1 above as we consider them to be efficient costs.

	Consultation	Consultation (3rd party Contribution)	Revised
NGN Gross Cost	5.24	5.24	5.24
Contribution	0.00	-0.52	-0.52
NGN Net Cost	5.24	4.72	4.72
Allowance	4.17	4.17	4.72
Totex 'Overspend'	1.07	0.55	0.00
TIM %	49%	49%	49%
TIM Value	0.52	0.27	0.00
Customers contribution	4.17	4.17	4.72
	0.55	0.28	0.00
	4.72	4.45	4.72
NGN contribution	0.52	0.27	0.00
BLCH contribution	0.00	0.52	0.52
	5.24	5.24	5.24

The first column calculates the allowances and what contributions are made by customers and NGN, assuming there is no contribution from BLCH.

- The gross and net costs are £5.24m
- Customers contribute £4.72m – made up of the original allowance and their share of the Totex 'overspend'
- NGN pays £0.52m – made up of its share of the Totex 'overspend'

The second column shows what happens when the contribution is made by BLCH

- The net costs are now £4.72m
- This reduces the Totex 'overspend' to £0.55m
- Customers now contribute £4.45m – made up of the original allowance and their share of this reduced Totex 'overspend'
- NGN pays £0.27m – its share of the Totex 'overspend'
- BLCH pays £0.52m

The net effect is that customers contribute less (c85%) and NGN/BLCH contribute c15%.

The third column revises the methodology further to ensure customers contribute 90% and BLCH contributes 10%. In order to do this the allowance should be set at the net cost to NGN of £4.72m. In this case there is no Totex overspend, customers contribute the £4.72m allowance, after BLCH has made its contribution.

Question 4: Do you have any views on the draft direction contained in Appendix 1?

Yes. We broadly agree with the draft direction set out in Appendix 1, however propose the following changes to be applied to the direction in Ofgem's Final Determination.

1. Point 5 and Point 6 - The approved amount should be updated to reflect the correct cost value as outlined in NGN's response to Question 3 and the correct company contribution. Should Ofgem accept NGN's challenge to its efficiently assessed costs, we consider this value should be an approved amount of £4.72m in 18/19 values and a BLCH contribution of £0.52m. This is outlined in the table below:

Annex 1: SpC 3.9 Net Zero Pre-construction Work and Small Net Zero Projects (£m, 18/19 prices)

Distribution Network/Regulatory Year	2021/22	2022/23	2023/24	2024/25	2025/26	Total
Northern Gas Networks plc	0.00	0.00	0.00	1.65	3.07	4.72

2. Point 7b – please see below a revised list of project deliverables and associated deadlines. The deadlines have been revised since NGN's submission due to the delay in award of funding following consideration of the project by Ofgem.

Annex 2: Project deliverables

Reference	Proposed project deliverable	Indicative deadline	Evidence
1	Submission of interim report	31/06/25	The report should set out: c) Completion of design, procurement and main contract award, d) Progress on construction commencement
2	Submission of interim report	31/01/26	The report should set out completion of main works.
3	Submission of close-down report	31/04/26	The report should set out: d) Completion of all site works and commission of equipment, confirming the Project has been successfully delivered, and any instance of under or non-delivery e) How the project learnings have been shared with relevant stakeholders, f) Any further requirements set out in the re-opener guidance document

The changes proposed above would also need to be updated in Annex 1 and Annex 2 of the final direction respectively.

If there are any queries or additional information or clarity required for any of the NGN responses, please do not hesitate to contact Paul Chapman, Head of Innovation, pchapman@northerngas.co.uk.

Kind regards

A handwritten signature in black ink, appearing to read 'Greg Dodd'.

Greg Dodd | Regulation & Strategic Planning Director

Northern Gas Networks