Network Innovation Competition Full Submission

Supplementary Answer Form

Tick if this answer is Confidential: ☐

Tick if this answer has been provided verbally: ☐

Project code:	NGN GN 01	Question Number	11
Question date	03 October 2013	Answer date	08 October 2013
Submission section question relates to			
Topic			
Question	Please explain what allowances you have for these investments in the price control. Will consumers pay twice?		
Notes on question			
Answer	As part of the RIIO-GD1 price control allowances NGN have a capital expenditure allowance of £20m to deliver the replacement of 32 Water Bath Heaters and 26 Boiler Packages. The requirement for the replacement of these assets is based upon current and forecast deteriorating asset condition and performance. As such these assets present an unacceptable level of risk to NGN and its customers. Under the RIIO framework NGN has a clear and definite output obligation to deliver the improvements in asset health implied by the replacement of these assets. NGN's allowances are based upon the design, procurement and installation of the current industry standard technology of boiler packages. This is an efficient means of addressing the risk presented by the assets and provides the customer with a low risk and low unit cost solution. This is consistent with the low risk low return framework under RIIO. Conversely, the Low Carbon Gas Preheating (LCGP) project will trial and develop currently high unit cost new technologies that are high risk in nature. These risks reflect significant uncertainties around their long term		

reliability and uncertainty over capital, installation and operating costs. This risk profile is in stark contrast to the current business as usual arrangements and highlights very clearly why this project could not proceed without the relevant NIC funding.

However, NGN have identified that it is appropriate to consider if there could be an efficient sharing of these risks between NGN and its customers to ensure that value for customers is maximised within the funding constraints. To achieve this, consideration has been given to the use of the RIIO-GD1 allowances to fund an element of the LCGP Project. This approach requires an appropriate balance of three key issues:

1. The additional financial and operational risks that NGN would face in delivering its core RIIO outputs if the proposed new technologies are found not to be reliable, with a significantly increased whole life cost compared with more traditional technology. NGN would be required to reinvest in current technology at its own cost.

2. Customers do not pay twice for the replacement of preheating assets where the proposed new technologies are found not to be able to provide the required preheating outputs.

3. The significant value created for customers across the UK by the successful implementation of new technologies which provide no direct financial benefit to NGN.

In considering these issues it was concluded that it was appropriate for NGN to seek to bear a greater element of these risks by increasing the level of funding allocated to the project already provided within the RIIO-GD1 allowances. NGN will contribute £1.4m to the project (22% of total project costs) – which is ~£900k more than the mandatory element required by NIC governance and broadly represents the full installation and asset removal costs at the sites identified within the project.

This additional funding represents a significant increase in NGN's exposure to the risk of poor reliability and high whole life costs of the new technologies installed at these sites. Under this scenario, NGN would have to remove the new technologies from these sites and install current technologies to meet the RIIO output targets. The additional removal and installation costs would be funded directly by NGN and its shareholders.

Under the scenario where the new technologies prove to be fit for purpose and can be retained by NGN beyond the end of the project, there is potential for an element of NGN's original RIIO-GD1 allowances to remain unused. However, NGN will look to progress the optimum technology for the remainder of the preheating replacement programme within RIIO based on a proven cost benefit analysis (CBA) within RIIO-GD1.

- This will mean NGN are investing in more expensive technologies than traditional boiler houses which will be funded out of any headroom created from our original allowance.

- Wider benefits derived from the new technologies including reduced carbon can be delivered for

	customers earlier than anticipated. • This will allow the continued development of these technologies and the acceleration of their deployment beyond the scope and timescales of the original project. This approach we believe strikes an important and appropriate balance between the risks borne by NGN operating in a low risk and low return environment and customers funding through the NIC, Specifically it does not lead to NGN's customers paying twice for the same investment but instead ensures that each party faces the appropriate funding levels and associated risks to ensure that the project can proceed and deliver the wider, longer term benefits anticipated from the delivery of a successful project.
Attachments	
Verbal Clarifications (Consultants)	