



Making a positive difference  
for energy consumers

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Date: 12 February 2016

Dear Stephen

**Network Innovation Competition – amendments to Northern Gas Network’s City CNG submission**

This letter contains our<sup>1</sup> decision to approve the resubmission for Northern Gas Networks (NGN’s) City compressed natural gas (CNG) project (the project) and our decision to amend its Project Direction<sup>2</sup> dated 9 December 2015 to reflect the resubmission<sup>3</sup>. The amended Project Direction is in Schedule One to this letter.

**Background**

On 30 November 2015, we issued our decision<sup>4</sup> on the 2015 Gas Network Innovation Competition (NIC) which approved partial funding for NGN’s City CNG project, on the condition that it amended its submission to address the concerns highlighted in our decision. We issued a Project Direction on 9 December 2015 to NGN.<sup>5</sup> The Project Direction also stated that NGN would need to submit an amended submission, including a revised budget, as a condition of the project being funded as an Eligible NIC Project.<sup>6</sup>

**NGN’s resubmission**

On 1 February 2016, NGN provided a resubmission relating to its project to us. The areas on which we had asked for clarification, and our view on the resulting resubmission, are displayed in Table 1.

**Table 1 - Ofgem conditions for NGN Funding**

<b>The feedback we provided in our decision document</b>	<b>Our reflection on NGN’s resubmission</b>
<p><u>The core innovation</u> The core innovation is the novel charging arrangement for the connection – not the technicalities associated with a high pressure (HP) or CNG connection. Every submission should be very clear</p>	<p>We consider that the resubmission has a stronger focus on the core innovation of the project and how it will be explored. Some examples include:</p> <ul style="list-style-type: none"> <li>• Updating objective 2 to make it clear that the commercial and regulatory barriers</li> </ul>

<sup>1</sup> The terms ‘the Authority’, ‘Ofgem’, ‘we’, ‘our’ and ‘us’ are used interchangeably in this letter. The Authority is the Gas and Electricity Markets Authority. Ofgem is the Office of the Gas and Electricity Markets Authority.

<sup>2</sup> All capitalised terms not otherwise defined in this letter have the meaning given to them in the Project Direction.

<sup>3</sup> NGN’s final resubmission is available on our website as a subsidiary document

<sup>4</sup> <https://www.ofgem.gov.uk/publications-and-updates/gas-network-innovation-competition-2015-funding-decision>

<sup>5</sup> The Authority issued a Project Direction to NGN pursuant to the NIC Governance Document issued pursuant to Part E of Special Condition 1I (Network Innovation Competition) of the Gas Distribution Licence setting out the terms to be followed in relation to the project as a condition of it being funded under the Network Innovation Competition. The Project Direction can be found at: <https://www.ofgem.gov.uk/publications-and-updates/network-innovation-competition-project-direction-city-cng>

<sup>6</sup> Eligible NIC Project has the meaning given in the Licence

<p>on what the core innovation is, how it will be explored and what potential barriers may need to be overcome.</p> <p>Therefore the commercial and regulatory barriers which the project seeks to address should be better explained and highlighted throughout the document. This includes an articulation of how NGN will be able to learn about the barriers and potential solutions for them</p>	<p>associated with the novel commercial agreement will be considered</p> <ul style="list-style-type: none"> <li>• Explicitly listing the knowledge it expects the project to generate, which includes the regulatory considerations</li> </ul>
<p><u>Learning for network companies</u></p> <p>It is also important that the submission is clear on what the proposed outcomes are, and how any resulting innovation may be rolled out.</p> <p>An important element of the NIC is that there needs to be clear learning for the network companies. Therefore the submission needs to provide a more detailed description of the objectives and how the learning may be applied by others.</p>	<p>We are pleased to see that NGN has provided additional information on the potential learning from the project, relating to the novel commercial arrangement, that will be relevant for other network companies.</p> <p>This includes committing to provide feedback to network companies and publish network company-facing information which detail the learning about the novel charging arrangement.</p> <p>These commitments are reflected throughout the resubmission and the company-facing communication is committed to in an updated <u>Successful Delivery Reward Criterion</u>.</p>
<p><u>Partial funding</u></p> <p>We considered, and agreed with Expert Panel, that the core innovation could be delivered at a lower cost. It was recommended that NGN should revise its project costs based on the decision to award partial funding.</p>	<p>NGN has updated its figures to reflect the partial funding decision. Some examples include reducing the functionality of the website to reflect the fact that learning about the novel commercial agreement does not require the proposed level of live data. We consider that these changes are appropriate and have not materially impacted the benefits to customers associated with the project, nor the learning for network companies.</p> <p>NGN may still decide to go ahead with a more expensive connection than the NIC monies will cover, NGN has agreed in its resubmission to cover the difference itself. We are pleased to see this level of commitment to the project</p>

## Decision

We consider that NGN has taken on board the feedback we provided. It has scaled back some of the project (for example in reducing the functionality of the live web portal), and has considered alternative funding sources for the difference between the funding request and the funding given. NGN has explained in its resubmission that it is willing to fund the remaining connection costs, should the higher cost connection site be required. If this occurs, it has requested that any additional funding is returned to it first from the commercial arrangement with Leeds City Council, before any money is returned to consumers. We believe this arrangement is in the consumer interest because it will enable the NIC project to go ahead. The mechanism for returning this money to NGN and to consumers is subject to a licence modification, for which we will shortly be holding an informal consultation.

NGN has also developed its submission to detail where it will gain knowledge about the commercial and regulatory arrangements, and how it will be able to share it with other

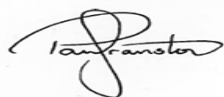
network companies, and any other interested parties. This includes commitment to a Successful Delivery Reward Criterion which includes producing a network-facing report on the learning from the project. We hope that this project will inspire industry-wide thinking about whether changes to commercial arrangements across the energy sector may be useful to help facilitate the connection of new customer types - many of which could bring significant environmental benefits.

We therefore accept NGN's resubmission, and revised budget. The amended Project Direction is appended to this letter. In accordance with Section 13 of the Project Direction, the Authority hereby amends the Schedule to the Project Direction in the manner set out in Schedule 1 to this letter.

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

If you would like to discuss any of the issues raised in this letter, please contact Tom Mackenzie at [thomas.mackenzie@ofgem.gov.uk](mailto:thomas.mackenzie@ofgem.gov.uk) or 020 7901 7406.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Paul Branston', written in a cursive style.

**Paul Branston**

Associate Partner, RIIO Networks  
**For and on behalf of the Authority**

# Schedule One

## Schedule to Project Direction

### 1. TITLE

Project Direction ref: NGN / The City CNG Project / ~~09 December 2015~~ 12 February 2016

### 2. PREAMBLE

This Project Direction is issued by the Gas and Electricity Markets Authority (the "Authority") to Northern Gas Networks (the "Funding Licensee") pursuant to the Gas NIC Governance Document issued pursuant to Special Condition 1I (Network Innovation Competition) of the Gas Distribution Licence (the "Licence"). It sets out the terms to be followed by the Funding Licensee in relation to The City CNG Project ("the Project") as a condition of the Project being funded under the NIC and the Funding Return Mechanisms<sup>7</sup>.

Unless otherwise specified, defined terms in this Project Direction have the meaning given to them in Appendix 1 of the Gas NIC Governance Document.

References to specific sections of the Funding Licensee's Full Submission in this Project Direction are, for ease of reference, made by referring to the section number in the Funding Licensee's Full Submission pro-forma.

### 3. CONDITION PRECEDENT

The Funding Licensee will not access any funds from the Project Bank Account until it has signed contracts with the Project Partners named in Table 1.

#### Table 1. Project Partners

Leeds City Council
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~~The Funding Licensee will not access any funds from the Project Bank Account until the Authority has decided that NGN has complied with the following conditions:~~

~~1) NGN revises its Full Submission to improve its clarity on the commercial and regulatory barriers that the Project seeks to overcome, and on the learning objectives and deliverables specifically related to the novel charging arrangement; and~~

~~2) NGN revises the figures in its Full Submission (including the budget spreadsheet), to reflect how any NIC funding will be spent in light of the Authority's decision to partially fund the Project.~~

~~The Funding Licensee will submit proposed revisions to the Full Submission to the Authority by 1 February 2016. The Authority will make a decision in writing in relation to whether to accept, or whether to reject, any proposed revisions made by NGN to its Full Submission.~~

~~If the Authority rejects the revisions proposed by the Funding Licensee, or the Funding Licensee does not submit its proposed revisions to the Full Submission to the Authority by 1 February 2016, then the Project must be halted (complying with paragraphs 8.30-8.34 of the Gas Electricity Governance Document). In this event the Approved Amount will be returned to customers and the Funding Licensee will retain its compulsory contribution and will not be eligible for the Successful Delivery Reward.~~

<sup>7</sup> The Funding Return Mechanism is defined in Special Condition 1I (Network Innovation Competition).

~~If the Authority makes a decision to accept the revisions to the Full Submission proposed by the Funding Licensee, the Authority may make changes to this Project Direction, in line with paragraphs 8.22 and 8.23 of the Gas NIC Governance Document.~~

#### **4. COMPLIANCE**

The Funding Licensee must comply with Special Condition 1I of the Licence and **with** the NIC Governance Document (as may be modified from time to time in accordance with Special Condition 1I and as modified and/or augmented in respect of the Project by this Project Direction) and with this Project Direction.

Any part of the Approved Amounts that the Authority determines not to have been spent in accordance with this Project Direction (or in accordance with the Gas NIC Governance Document) is deemed to be Disallowed Expenditure.

Pursuant to Special Condition 1I, Disallowed Expenditure is revenue received (whether by the Funding Licensee or by another Licensee) under the NIC and Funding Return Mechanisms that the Authority determines not to have been spent in accordance with the provisions of the Gas NIC Governance Document or with those of the relevant Project Direction.

Pursuant to paragraph 8.48 of the Gas NIC Governance Document, Disallowed Expenditure includes any funds that must be returned if the Project is halted without Ofgem's permission, any funds that have not been spent in accordance with the approved Project Budget contained within the Project Direction, and any unspent funds on the completion of the Project.

#### **5. APPROVED AMOUNT FOR THE PROJECT**

The Approved Amount is £700,000.

#### **6. PROJECT BUDGET**

The Project Budget is set out in Annex 1 to this Project Direction. The Funding Licensee must not spend more than 110% of any category total (e.g. "Labour") in Annex 1 without the Authority's prior written consent (such consent is not to be unreasonably withheld).

The Funding Licensee will report on expenditure against each line under the category total in the Project Budget, and explain any projected variance against each line total in excess of 5% as part of its detailed report which will be provided at least every six months, in accordance with paragraph 8.17 of the Gas NIC Governance Document. Ofgem will use the reported expenditure and explanation to assess whether the funding has been spent in accordance with the Gas NIC Governance Document and with this Project Direction.

For the avoidance of doubt this reporting requirement does not change or remove any obligations on the Funding Licensee with respect to reporting that are set out in the Gas NIC Governance Document.

#### **7. PROJECT IMPLEMENTATION**

The Funding Licensee must undertake the Project in accordance with the commitments it has made in the Full Submission approved by the Authority pursuant to the Gas NIC Governance Document and with the terms of this Project Direction. These include (but are not limited to) the following:

- (i) undertake the Project in accordance with the description set out in Section 2 (Project Description);
- (ii) provide a Network Licensee Compulsory Contribution of £70,000;

- (iii) complete the Project two years after station commissioning - anticipated to be ~~October 2019~~ **February 2020**; and
- (iv) disseminate the learning from the Project at least to the level described in Section 5 (Knowledge Dissemination).

## 8. REPORTING

Ofgem will issue guidance (as amended from time to time) about the structure and content of the reports required by paragraph 8.17 of the Gas NIC Governance Document. The Funding Licensee must follow this guidance in preparing the reports required by paragraph 8.17 of the Gas NIC Governance Document.

As required by paragraph 8.22 of the Gas NIC Governance Document, the Funding Licensee must inform the Authority promptly in writing of any event or circumstance likely to affect its ability to deliver the Project as set out in its Full Submission.

## 9. COST OVERRUNS

The maximum amount of Contingency Funding that the Funding Licensee can request as additional funding for cost overruns on the Project is 5%<sup>8</sup> of the Approved Amount.

NGN has stated that if it requires a more expensive connection than the partial NIC funding allows for, it will fund the difference itself and will not require the Contingency Funding. The Funding Licensee cannot request or receive any Contingency Funding should the more expensive connection be required.

## 10. INTELLECTUAL PROPERTY RIGHTS (IPR)

In Section 5 of its Full Submission (Knowledge Dissemination) the Funding Licensee has stated that the Project conforms to the default IPR arrangements set out in chapter 9 of the Gas NIC Governance Document. The Funding Licensee must therefore undertake the Project in accordance with the default IPR arrangements.

## 11. Returned Project Revenue

In line with the Funding Licensee's Full Submission, any additional funding which NGN provides to cover the connection costs can be recovered from the commercial agreement first, ahead of returning any additional revenue back to consumers. This arrangement applies until either the connection costs are paid off, or a ten year period from station commissioning is reached. This is subject to appropriate licence modifications being made to provide an explicit mechanism for this.

## 12. SUCCESSFUL DELIVERY REWARD CRITERIA

The Project will be judged by the Authority for the purposes of the NIC Successful Delivery Reward against the Successful Delivery Reward Criteria ("SDRCs") set out in Table 2 below (that comply with paragraphs 5.26 – 5.29 of the Gas NIC Governance Document).<sup>9</sup>

**Table 2. Successful Delivery Reward Criteria**

Successful Delivery Reward criterion	Evidence
9.1 Novel Commercial Arrangement	Agreement and formal sign on to the novel commercial arrangement required to recover the NIC funds costs associated with the High Pressure (HP) connection and metering unit. <b>This would demonstrate</b>

<sup>8</sup> This is the amount requested by the Funding Licensee in its Full Submission, or the default of 5%.

<sup>9</sup> These are the Successful Delivery Reward Criteria set out in the Funding Licensees Full Submission.

June 2016.	overcoming of any initial barriers to the use of such an agreement.
9.2 Design of HP pipeline	<p>As described in section two of the City CNG submission the design of the HP pipeline will commence after LCC have:</p> <ul style="list-style-type: none"> <li>• Confirmed the land for the CNG site.</li> <li>• <del>Signed off contracts with their 3<sup>rd</sup> Party Contractor.</del></li> <li>• Signed NGN's connection agreement (including the novel commercial arrangement).</li> </ul> <p>Following achievement of these milestones the design of the HP connection pipeline will be completed within six months.</p>
9.3 Build of HP connection pipeline and commissioning of a functioning station  Functioning station	<p>As described in section two of the City CNG submission the build of the HP pipeline will commence once the 3rd Party Contractor has mobilised to site or NGN have written confirmation the build is to proceed including start dates. <del>Once this has been achieved the HP pipeline will be completed within seven months.</del></p> <p>The station will be designed to correctly integrate with NGNs HP pipeline and meter skid, with storage and compression capacity to serve the outline customer base as modelled in the 'realistic' scenario. <b>The HP connection will be constructed within 10 months of the CNG Station construction commencing.</b> The station shall open 'on-time' at a date agreed during their appointment and be ready to serve customers on day one. All equipment shall be fully operational, and staff fully trained to operate and assist customers. <b>This will demonstrate overcoming of any commercial or regulatory barriers to getting the station built and operating.</b></p>
9.45 Vehicle usage is in line with estimate	<p>The projections made in the 'realistic' business model scenario are met or exceeded. <b>At project end, the usage profile will be re-evaluated against the realistic business model to make a case to determine whether the realistic business case is on target to be achieved. This will be reported to also determine if the realistic business case needs to be revised based upon usage.</b></p>
9.65 Knowledge, Learning and Dissemination Strategy (a) Deliver project website, accessible by all interested parties, by December 2016.  9.7 Knowledge, Learning	<p><del>Deliver project web portal, accessible by all interested parties. Web portal procured December 2016.</del></p> <p><b>Website to contain:</b></p> <ul style="list-style-type: none"> <li>• Progress reports</li> <li>• Relevant case studies</li> <li>• Information on station usage + vehicle</li> </ul>

<p>and Dissemination Strategy (b)</p>	<p>conversion rates (within 3 months of commissioning)</p> <ul style="list-style-type: none"> <li>• Communications on regulatory and commercial barriers</li> <li>• Lessons learnt</li> <li>• Data on webportal<del>site</del> to include progress reports, and any relevant case studies, designs etc. from the work undertaken to date.</li> </ul> <p>Information from the CNG fuelling station to be available on the web portal within three months of station commissioning, this is intended to include:</p> <ul style="list-style-type: none"> <li>• <del>Daily usage at the gas meter</del></li> <li>• <del>Daily usage at the pump</del></li> <li>• Vehicle refilling patterns</li> <li>• Vehicle conversion rates</li> <li>• Case Studies from LCC and NGN</li> <li>• Communication of regular and commercial barriers</li> <li>• Lessons learnt from project</li> </ul>
<p>9.86 Project Evaluation and final report.</p>	<p>The novel commercial arrangement for the project will continue for a ten year period from station commissioning. However a final report will be produced two years after station commissioning which is currently anticipated to be <del>October 2019</del> February 2020. This report will act as the end of the NIC project. However the webportal<del>site</del> and commercial operation will continue as described in the submission.</p> <p>The report will also include a specific section targeted at network companies, which will be published, to look at the regulatory and commercial barriers to the novel commercial arrangement.</p>

The maximum amount of the Gas NIC Successful Delivery Reward (which will not exceed the Network Licensee Compulsory Contribution) that the Project will be eligible for is £700,000~~78,691~~.

## 12. USE OF LOGO

The Funding Licensee and Project Partners, External Funders and Project Supporters<sup>10</sup> may use the NIC logo for purposes associated with the Project but not use the Ofgem or Ofgem E-Serve logos in any circumstances.

## 13. AMENDMENT OR REVOCATION

As set out in the Gas NIC Governance Document and this Project Direction, this Project Direction may be amended or revoked under the following circumstances:

- (i) if the Funding Licensee considers that there has been a material change in circumstance that requires a change to the Project Direction, and the Authority agrees (paragraph 8.23 of the Gas NIC Governance Document); or

<sup>10</sup> As listed in Box 1.6 in Section 1 of the Full Submission pro-forma.



- (ii) if Ofgem agrees to provide Contingency Funding, which requires the re-issue of the Project Direction (paragraph 8.42 of the Gas NIC Governance Document); or
- (iii) if the Funding Licensee applies for Contingency Funding to cover a decrease in Direct Benefits and the Authority decides it would be in the best interest of customers to make changes to the Project Direction before the Contingency Funding would be awarded (paragraph 8.42 of the Gas NIC Governance Document); or
- (iv) to reflect amendments made to the Licence.

#### **14. HALTING OF PROJECTS**

This Project Direction is subject to the provisions contained in paragraphs 8.30 to 8.34 of the Gas NIC Governance Document relating to the halting of projects. By extension, this Project Direction is subject to any decision by the Authority to halt the Project to which this Project Direction relates and to any subsequent relevant Funding Direction issued by the Authority pursuant to Special Condition 1I of the Licence.

In the event of the Authority deciding to halt the Project to which this Project Direction relates, the Authority may issue a statement to the Funding Licensee clarifying the effect of that halting decision as regards the status and legal force of the conditions contained in this Project Direction.

#### **NOW THEREFORE:**

In accordance with the powers contained in the Gas NIC Governance Document issued pursuant to Special Condition 1I of the Licence the Authority hereby issues this Project Direction to the Funding Licensee in relation to the Project.

This Project Direction constitutes notice of reasons for the Authority's decision pursuant to section 38A of the Gas Act 1986.

## ANNEX 1: PROJECT BUDGET

<b>Cost Category</b>	<b>Cost (£)</b>
Labour	-
Equipment	130,431.00
Contractors	498,193.00
IT	-
IPR Costs	-
Travel & Expenses	-
Payments to users	-
Contingency	108,292.89
Decommissioning	-
Other	50,000.01
<b>Total</b>	<b>786,916.90</b>