

Governance Document

Net Zero and Re-opener Development UIOLI allowance Governance Document

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Overview:

This Governance Document is for the Net Zero and Re-opener Development use-it or lose-it allowance ("NZARD UIOLI"), referred to under Special Condition 3.5 of the Electricity Transmission Licence, Special Condition 3.5 for Gas Distribution Licensees and Special Condition 3.5 for the Gas Transmission Licensee.

One of the key objectives of the RIO-2 price control is to prepare the network licensees to deliver Net Zero at the lowest cost to consumers, while maintaining world-class levels of system reliability. The purpose of this allowance is to enable Network Licensees to fund small Net Zero facilitation projects, and also to allow for early development work on projects that companies intend to bring forward at a later stage through other applicable net zero-related re-openers.

This Governance Document sets out the detailed arrangement for this allowance, including scope details and maximum spend available. Network Licensees are required to comply with this document under their NZARD UIOLI licence conditions as if it forms part of their licence.

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Context

The UK has a statutory target to achieve net zero carbon emissions by 2050, with the Scottish parliament setting their target for net zero in 2045. As the energy regulator, Ofgem¹ has an important role in paving the way for the energy sector to decarbonise at the lowest cost to consumers.

In December 2020, we published our Final Determinations² for the RIIO-2 price control for the Electricity Transmission (ET), Gas Distribution (GD) and Gas Transmission (GT) sectors for 2021 to 2026. This included our approach to uncertainty around developments during the price control period in respect of net zero.

Where there was uncertainty at the start of the price control regarding whether a particular investment was required, or where the scope or cost of the investment was unclear, we set out a range of uncertainty mechanisms to enable the price control to flex when investment needs become clearer. To enable necessary development work on net zero projects and the progression of low-regret Net Zero facilitation capital projects for the gas sector, we introduced the Net Zero and Re-opener Development use-it-or-lose-it allowance (NZARD UIOLI).

NZARD Governance Document

This document is the NZARD Governance Document and sets out the regulation, governance and administration of the NZARD allowance.

In this document we use the terms 'Ofgem' and 'the Authority' as well as the terms 'we', 'us' and 'our' interchangeably. Ofgem is the Office of the Gas and Electricity Markets. The Authority is the Gas and Electricity Markets Authority and is the governing body of Ofgem, consisting of non-executive and executive members.

Defined terms are capitalised throughout the text, with the definitions set out in chapter 4.

¹ The terms 'Ofgem', 'the Authority', 'we' and 'us' are used interchangeably in this document.

² <https://www.ofgem.gov.uk/publications-and-updates/riio-2-final-determinations-transmission-and-gas-distribution-network-companies-and-electricity-system-operator>

In this document “Network Licensee” means the holder of an Electricity Transmission Licence, a Gas Distribution Licence, or a Gas Transmission Licence, regulated through the RIIO price control framework.

Review

Ofgem may from time to time, following consultation with Network Licensees and other interested parties, revise this NZARD Governance Document in accordance with the NZARD Licence Condition.

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1. Introduction

The Net Zero and re-opener development allowance

- 1.1. The Net Zero and Re-opener Development (NZARD) use-it-or-lose-it (UIOLI) allowance is a RIIO-2 fund designed to enable small gas Net Zero facilitation projects and to allow early development work on projects that companies may bring forward under the following re-openers:
- ET, GT, and GD – Net Zero Re-opener
 - GT and GD only - Net Zero Pre-construction and Small Projects Re-opener
 - GD only – Heat Policy re-opener and New Large Load Re-opener (if Net Zero related)
 - ET only – Medium Sized Investment Projects (MSIP) Re-opener
- 1.2. We created this allowance, as described in our RIIO-2 Final Determinations³, following feedback that our uncertainty framework as set out at Draft Determinations left a funding gap for the early development work that Network Licensees need to do on projects that they may to bring forward through re-openers. Respondents also highlighted that there was a funding gap for very small Net Zero facilitation projects in the gas sectors that may be low in materiality but high in impact and consumer value.
- 1.3. Our RIIO-2 Final Determinations provided network licensees with the following NZARD allowances:
- NGET - £16.0m
 - SHET - £12.0m
 - SPT - £12.0m
 - Cadent - £19.8m
 - NGN - £4.5m
 - SGN - £10.8m
 - WWU - £4.7m
 - NGGT - £8.3m

³ Chapter 8 of the RIIO-2 Final Determinations Core Document

2. Eligible NZARD Expenditure

- 2.1. Expenditure under the NZARD UIOLI allowance may be incurred in relation to two broad areas:
- **small Net Zero facilitation projects** in the GD and GT sectors; and
 - **early development work** on projects that companies intend to bring forward under specific re-openers across the ET, GD and GT sectors.
- 2.2. This chapter sets out the specific costs that are included under each of the above areas and specifies restrictions on how expenditure against the NZARD allowance may be incurred.

Small Net Zero facilitation projects

- 2.3. The NZARD allowance may be used to fund low regret capital projects in the GD and GT sectors that have a high Net Zero impact but are not captured by other mechanisms.
- 2.4. 'Low regret' in this context recognises that whilst there is significant uncertainty that surrounds the future of the gas networks, there are some areas the GD and GT sectors can invest in which hold relatively low policy risks – and there is a certainty of outcomes, with clear evidence of the need and benefit for consumers.
- 2.5. GD and GT Network Licensees should not use the NZARD allowance for Net Zero facilitation capital projects expected to cost more than £2m. Such projects can instead be brought forward under other regulatory mechanisms, such as, the Net Zero pre-construction and small projects re-opener which is available to both the GD and GT sectors.
- 2.6. Where Network Licensees use their NZARD allowance for Net Zero facilitation capital projects, we expect Licensees to develop a common proforma to fill out. This may evolve over time and Ofgem may require changes to be made.

Early development work

- 2.7. Network Licensees may be required to undertake development work on a project prior to a submitting a full funding request through a re-opener, but it may not have been funded to do so elsewhere in the price control. In such instances, the NZARD allowance may be used for early development work, such as:
- Front End Engineering Design (FEED) studies. This could include early desk-based research and design, comparison of different options and development of project plans.
 - Pre-FEED work– this can also include risk assessment and establishing a needs case.
 - Detailed technical design and engineering development of the chosen option.
 - Work required to secure planning consent for the project, including planning consultations, wayleaves, legal costs, and planning applications.
 - Associated customer and stakeholder engagement.
- 2.8. NZARD expenditure can be incurred in relation to early development work on projects which would ultimately be eligible for submission under the following re-openers:
- ET, GT, and GD – Net Zero Re-opener
 - GT and GD only - Net Zero Pre-construction and Small Projects Re-opener
 - ET only – Medium Sized Investment Projects (MSIP) Re-opener
 - GD only – Heat Policy re-opener and New Large Load Re-opener (if Net Zero related)
- 2.9. NZARD expenditure in relation to early development work should not exceed £2m per project. This will ensure that the total allowance can be used across a variety of potential projects, and that the Network Licensee’s NZARD allowance is never exhausted on one project (which would be especially detrimental to consumers if that project didn’t ultimately progress). Where £2m is not sufficient to cover all costs associated with early development, Network Licensees can request additional costs through the re-opener submission for that project, though approval of such requests will not be guaranteed and will be subject to the re-opener process.

3. Annual regulatory reporting for NZARD projects

- 3.1. The Network Licensee must report the required details for its NZARD expenditure as set out in Condition B15 (Regulatory Instructions and Guidance) of the Electricity Transmission Licence Standard Conditions, and Condition A40 (Regulatory Instructions and Guidance) of the Gas Transporter Standard Licence Condition.

4. Definitions

Heat Policy re-opener

The Re-opener described in Special Condition 3.19 in the Gas Distribution Licence (Heat Policy and energy efficiency Re-opener). Created to respond to policy decisions on the future of gas and heat.

Medium Sized Investment Projects (MSIP) re-opener

An annual RIIO-ET2 re-opener which allows ETOs to bring forward funding requests for sub-£100m projects across a range of different areas, most of which are driven by third parties.

The Net Zero and Re-opener Development use-it-or-lose-it allowance

Means the allowance set out in this Governance Document.

Net Zero Pre-construction and Small Projects re-opener

The Re-opener described in Special Condition 3.9 in the Gas Distribution Licence and Gas Transmission Licence (Net Zero Pre-construction Work and Small Net Zero Projects Re-opener). Created to capture pre-construction work and small value Net Zero facilitation projects.

Net Zero re-opener

Created to allow changes in policy, the role of the network companies, as well as technological or market changes to be reflected in company allowances.

Network Licensee

Means the holder of an Electricity Transmission Licence, a Gas Distribution Licence, or a Gas Transmission Licence, regulated through the RIIO price control framework.

New Large Load re-opener

The Re-opener described in Special Condition 3.22 in the Gas Distribution Licence. Created to increase baseline allowances to fund specific network reinforcement driven by the connection of large loads and gas producers.