

Interested parties and
stakeholders

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Dear colleagues,

RiIO-T1: Our decision on National Grid Gas Transmission's application under the Industrial Emissions Costs reopener

This letter sets out our¹ final decision on National Grid Gas Transmission's (NGGT's) price control re-opener application, made under Special Condition 5E of NGGT's Gas Transporter licence, in relation to Industrial Emissions Costs.

NGGT's application sought a reduction to its baseline allowances so that it retains £123.4m² of the £288m allowances originally provided in relation to the recovery of Industrial Emissions Costs. This required a downward adjustment of £164.6m to its allowances. In August 2018 we published our initial views on NGGT'S application and sought the views of interested parties on the issues set out in that document.³ We received four responses in total, all of which have been published on our website.⁴

Summary of our final decision

We have decided to reduce NGGT's baseline allowance by £287.5m, thereby allowing NGGT to retain £0.53m of its allowances for emissions control work. We reached this decision having considered the responses to our consultation and taking account of our powers and duties under the Gas Act 1986, and in accordance with Special Condition 5E of NGGT's Gas Transporter licence.

Our decision in relation to the various works proposed by NGGT is set out below:

- St Fergus and Hatton: we maintain our view that there remains uncertainty about the best solution and the costs associated with that solution. We think it is in consumers' interests to provide funding at a later date when there is greater certainty both about the solution and associated costs. This decision letter sets out our policy on how these costs may be assessed and funded in the future.
- Peterborough and Huntingdon: we maintain our view that the proposed works are required to meet outputs set as part of RiIO-T1, and that funding has been

¹ The terms the 'Authority', 'Ofgem', 'we' and 'us' are used interchangeably in this letter. The Authority is the Gas and Electricity Markets Authority. Ofgem is the office of the Authority.

² All costs in this document are reported in the 2009/2010 price base, unless otherwise stated.

³ <https://www.ofgem.gov.uk/publications-and-updates/consultation-riio-1-price-control-reopeners-may-2018>

⁴ <https://www.ofgem.gov.uk/publications-and-updates/consultation-draft-decision-nggts-application-under-riio-t1-compressor-emissions-uncertainty-mechanism>

provided for work to meet those outputs. We had previously clarified our position on these outputs in our Mid Period Review (MPR) parallel work decision in 2017.

- For the remaining sites, we maintain our view that the proposed works are not required to comply with emissions legislation. There is one exception to this: we consider that some work done in Wisbech does qualify for funding of £0.53m under this reopener.

In conclusion, we maintain our view that NGGT has not substantiated its request to retain £123.4m of funding for compliance with emissions control legislation, with the exception of £0.53m for work that has been done at Wisbech.

The rest of this letter sets out the relevant background, a summary of stakeholder views received in response to our consultation, and the reasons for our decision.

Background

NGGT operates a number of gas fired compressors across the gas transmission network. These compressors maintain the pressure of gas on the network and help ensure that gas is transported across Great Britain to areas where it is needed. The operation of gas compressors results in the emission of air pollutants (primarily carbon monoxide and nitrogen oxides), which NGGT is legally obliged to control and manage.

In its business plan submission for RII0-T1, NGGT had forecast expenditure of £813.5m to ensure compliance with emissions control legislation. We considered at the time that NGGT's proposals were not sufficiently justified. Following our assessment in 2012, we provided baseline funding of £142.7m for compliance with emissions control legislation at three sites. We said this would cover IPPCD phase 3 works at Peterborough and Huntingdon, and IED phase 1 work at Aylesbury.

We acknowledged that NGGT might need to undertake emissions compliance work at other sites as part of the next phase of works (which NGGT referred to as IPPCD phase 4 and IED phase 2 works). We provided an allowance of £9m to produce an integrated plan to carry out works required as part of IPPCD Phase 4 and IED Phase 2. We said that this plan would need to demonstrate comprehensive cost benefit analysis of all the engineering and commercial options available to NGGT. Additionally, we included an uncertain allowance of £288m for the IPPCD Phase 4 and IED Phase 2 projects, based on NGGT's business plan submission which envisaged work at Alrewas, Diss and Wormington compressor stations. We said that if "NGGT's planned expenditure is different to this amount, we will adjust the baselines up or down".

We introduced a reopener mechanism in order to allow NGGT to seek appropriate funding for costs associated with IPPCD Phase 4 and IED Phase 2 projects. The reopener mechanism included two application windows, in May 2015 and in May 2018. The Gas Transporter licence defines the costs that are eligible to be considered as part of the reopener. These are defined as:

"costs incurred, or expected to be incurred, by the Licensee in relation to works triggered as a result of emissions related legislation, such as Directive 2008/1/EC of the European Parliament and of the Council of 15 January 2008 concerning integrated pollution prevention and control, and Directive 2010/75/EU of the European Parliament and of the Council of 24 November 2010 on industrial emissions (integrated pollution prevention and control)."

In May 2015 NGGT submitted a reopener application to increase its uncertain allowances by £41.0m. We rejected NGGT's application as NGGT had not considered all the options available to it in sufficient detail and did not carry out a comprehensive cost benefit analysis to support its choice of solutions. We did not express a view on whether the proposed works at any site or the associated costs were reasonable.

In May 2018, we received a further reopener application from NGGT, this time to reduce its uncertain allowances to £123.4m, which is a reduction of £164.6m from the baseline allowance of £288m. The allowance that it proposed to retain related to costs that it has incurred or expects to incur at nine compressor sites. Further details of NGGT's application were provided in our consultation document.⁵

Our initial views

St Fergus and Hatton

In our consultation document, we set out our view that there is considerable uncertainty about the solution that would deliver the most benefits for consumers at St Fergus and Hatton. At the time of its application, NGGT had not yet confirmed its preferred option at either site. Its current plan is that it would make a final decision in 2019 following the completion of its Front End Engineering Design (FEED) work.

At St Fergus, we were not convinced by NGGT's CBA and its conclusions. For instance, we note that the proposed works would maintain the compression capability at the site, partly with a view to new emissions restrictions that may come into force by 2030. We said that the precise requirements beyond 2030 would become clearer in the future, and the most efficient long term solution at St Fergus for consumers may look different then.

At Hatton, NGGT had indicated that the determination of the most efficient solution would depend on the outcome of its FEED study, which would look at a broad range of options, including those involving fitting emissions abatement technology on existing gas compressors, potentially at a lower cost than installing a new 30MW gas compressor.

Given this, we did not believe that there is sufficient certainty to provide funding through the current reopener process. We said that the FEED studies at both sites would provide a more robust basis for deciding the most efficient solution. We said that we would consider providing appropriate funding as part of the RIIO-T2 settlement as long as NGGT is able to justify the need for the investment, the solution chosen, and the level of efficient costs.

We recognised that NGGT may need to incur expenditure at either St Fergus or Hatton relating to compliance with emissions control legislation during the RIIO-T1 period (i.e. before April 2021), and if so, we said that we would consider providing appropriate funding as part of the close out process for RIIO-T1, provided NGGT is able to demonstrate that the expenditure was necessary, proportionate and efficient.

Finally, we said that we would work with NGGT in the coming months to agree a process by which NGGT can apply for appropriate funding for works at St Fergus and Hatton that are carried out during the RIIO-T1 period, and the information that we would be looking for from NGGT to support its application.

Peterborough and Huntingdon

NGGT requested funding for one 15.3MW gas compressor each at Peterborough and Huntingdon as part of its reopener application. We considered the funding that we had previously provided for emissions compliance work at these two sites and whether additional funding through this reopener is appropriate.

In its business plan submission for the RIIO-T1 price control, NGGT said that its proposed solution for emissions compliance at Peterborough and Huntingdon was to install one new large 35MW VSD compressor unit at each site as part of IPPCD Phase 3 works. While we

⁵https://www.ofgem.gov.uk/system/files/docs/2018/08/industrial_emissions_costs_nggt_consultation_document_ofgem_public_version_-_may_2018.pdf

disagreed with the size of the proposed new units, we agreed at the time that a large VSD unit would be the right solution at these sites and provided funding on the basis of one 24MW VSD unit at each site. This funding was included in the baseline allowance for emissions compliance work at Peterborough, Huntingdon and Aylesbury.

Subsequently, NGGT undertook further analysis including a Best Available Technique (BAT) assessment, which concluded that the best solution at these sites was not one large unit but instead three small 15.3MW gas units. NGGT subsequently revised its assessment to two small 15.3MW gas units. NGGT's view is that, at each site, one 15.3MW unit should be treated as meeting the requirements of IPPCD Phase 3 (which has been previously funded), and the other 15.3MW unit should be treated as being part of IPPCD Phase 4 works (which is subject to this reopener).

We reviewed the annual Network Review reports that NGGT had submitted to the Environment Agency (EA) and the Scottish Environment Protection Agency (SEPA) and concluded that *"the programme of works [for which NGGT is requesting funding for as part of the 2018 reopener] at Peterborough and Huntingdon were initially treated by NGGT for the purposes of its engagement with the EA as being part of Phase 3 works"*. For funding purposes after 2015 it has started to refer to them as Phase 4 works.

We assessed the above evidence in light of the MPR Parallel Works Decision where we were considering clawing back allowances from NGGT where it had changed the solution adopted to generate considerable savings at Aylesbury (approx. £50m compared to allowances). Based on NGGT's submission and stakeholder feedback we said we *"would consider the output delivered if NGGT can justify that it complied with the IED in a manner which has delivered the greatest value to consumers"*.

We noted that NGGT's view of the efficient solution at Peterborough and Huntingdon had changed; however, as in the Aylesbury case we expected NGGT to meet the cost of its preferred solution from the allowances provided. The outputs set for NGGT at Peterborough and Huntingdon would only be delivered once the most efficient solution for emissions control compliance at these sites have been delivered in full.

After considering the evidence, we took the initial view that NGGT has already been funded for the efficient solution for emissions compliance and rejected NGGT's request for additional funding at Peterborough and Huntingdon.

The remaining sites

NGGT requested funding for asset health and decommissioning for five compressor sites (Moffat, Carnforth-Nether Kellet, Warrington, Wisbech and Kirriemuir). Our initial view was that the proposed works at four of the five sites are not required for compliance with emissions control legislation, and are therefore out of scope of this reopener. At the fifth site (Wisbech), we considered part of the proposed work to be within scope, and we proposed to allow £0.53m of funding.

Stakeholder views

We received four responses to our consultation, including one from NGGT.

General comments

One respondent (Energy UK) said that the volume and complexity of the material included in our consultation placed an unfair burden on interested parties, and that our three-week consultation period made it difficult to engage with the consultation in any meaningful way. The same respondent said that Ofgem's assessment of NGGT's proposals takes a *"very narrow interpretation of the re-opener provisions on a site by site basis rather than considering the network in a holistic manner"*. The response sought clarification on:

- Whether Ofgem had considered the impact of the funding decision on network capability, resilience, flexibility and assured pressures. While the respondent accepted that the consultation was *“primarily about achieving compliance with emissions legislation this should not lead to reduced obligations and levels of service in these areas.”*
- Whether interactions with our decision on another reopener application by NGGT (i.e. Feeder 9) in relation to these issues have been taken into account.
- Whether our funding decision would leave sufficient time for delivery of long lead time items.

The same respondent expressed concerns that there was a difference of opinion between Ofgem and NGGT on the magnitude of baseline allowances provided. The response also queried whether Ofgem had engaged with the EA as part of its assessment. The response welcomed the fact that actual expenditure on emissions compliance was *“well below”* NGGT’s original forecast of £813m.

One respondent (Centrica Group) welcomed Ofgem’s proposal to remove ex ante funding for sites that no longer needed investment to comply with environmental legislation. The response also noted that it is important to consider the impacts on network capability, resilience and flexibility as part of our decisions on this and other reopeners.

NGGT responded to our consultation raising a number of areas of disagreement with our initial proposals. NGGT said that our proposals introduce *“further regulatory uncertainty”* and undermines its ability to fund the emissions compliance programme in *“an efficient and effective manner”*. NGGT provided detailed comments on each funding area, and these are summarised in the relevant sections below. NGGT also made a general comment on stakeholder engagement. It said that stakeholders had expressed broad support for its proposals in 2015 and 2018, and that by taking the position set out in our consultation, Ofgem *“risk alienating”* them.

St Fergus and Hatton

One respondent (Citizens Advice) expressed concerns about the decision making process for NGGT’s compressor sites, and said that *“Ofgem should prioritise their decision on the needs case for upgrades to these sites. Waiting until the RIIO-T2 price control to do this may not promote the most efficient management of the pipeline system”*.

One respondent (Centrica Group) agreed with our proposal to defer ex ante funding for St Fergus and Hatton until there is greater certainty about the precise solution at each site. The response noted that given the time required by NGGT to complete the FEED it is appropriate to revisit the funding decision at the RIIO-T2 price control review.

NGGT’s response disagreed with our view that there is insufficient certainty to provide the allowances as requested for St Fergus and Hatton. NGGT said that, on both sites, its proposed solutions have been through early-stage internal governance processes, and appropriate solutions are being progressed. At Hatton, only one option is being progressed to the next stage, and at St Fergus two options are being progressed – but the cost differential between the two options is relatively low (£4m).

NGGT said that our statements about the uncertainty of the requirements of the Medium Combustion Plant (MCP) legislation – which comes into force in 2030 – indicates that we may not approve (and fund) during our RIIO-T2 assessment, any expenditure that NGGT incurs at these sites during the RIIO-T1 price control period. NGGT believes that uncertainty about Ofgem’s position gives it *“no confidence in progressing work at this stage”*.

NGGT stated that there is a need at both sites to deliver *“solutions to ensure environmental compliance by 2023”*, and that it needs to progress work with sufficient funding certainty over the next three years. Without this progress, NGGT said that it *“will be unable to*

operate the [non-compliant units at these sites] beyond 2023 which introduces risk of network constraints”.

Peterborough and Huntingdon

One respondent (Centrica Group) agreed with Ofgem that a consistent approach should be taken for expenditure at Peterborough, Huntingdon and Aylesbury. The response said that it agreed with Ofgem that focus should be placed on the outcome where any ambiguity exists about the particular solution. The response welcomed Ofgem’s intention to review how outputs and deliverables can be better defined in the RIIO-2 price controls.

NGGT’s response raises a number of points relating to our treatment of funding requests for Peterborough and Huntingdon.

NGGT’s view is that the regulatory output that we set for IPPCD Phase 3 works at Peterborough and Huntingdon should be considered as met by the installation of one new 15.3MW gas compressor unit at each site. Additional units at both sites should be treated as part of Phase 4 work, and therefore should be separately funded as part of the reopener. NGGT believes that it had previously informed stakeholders and Ofgem of its plans for meeting the Phase 3 and Phase 4 outputs in this way, both through its submission for the May 2015 reopener and through annual regulatory submissions. NGGT believes that, by not expressly querying or challenging its categorisation of Phase 3 and Phase 4 works, Ofgem had accepted NGGT’s view.

NGGT said that if Ofgem had intended to take a different view of the Phase 3 output, and whether this was met by installing one 15.3MW unit at each site, Ofgem should have made this clear in its 2015 reopener and MPR (Parallel Works) consultation and decision documents. NGGT further said that if Ofgem had provided its own view, rather than NGGT’s view, of total forecast costs for meeting the Phase 3 output, stakeholders would have responded differently to those consultations. Furthermore, NGGT believes that Ofgem’s view of the Phase 3 output is inconsistent with the approach taken at previous price controls (in relation to Phase 1 and 2 works at St Fergus, Hatton and Kirriemuir), where we had not required NGGT to address emissions compliance at a site-level.

NGGT said that it is inappropriate for Ofgem to take account of its performance against allowances on other projects, such as Aylesbury, in reaching a view on the funding for Peterborough and Huntingdon.

NGGT said that its phased approach to emissions control work is good practice that has “*maximised emissions reductions*” whilst “*minimising expenditure*”, and that Ofgem’s proposed treatment of funding has introduced “*regulatory uncertainty*” that has undermined this good practice.

Other sites

NGGT’s response disagreed with our view that the proposed works at all sites except Wisbech are out of scope of the industrial emissions reopener. NGGT said that Ofgem had previously accepted that compliance with emissions control legislation could be delivered through a range of alternatives to like-for-like replacement, including “*decommissioning, retrofitting, exchange of non-compliant turbines etc*”. NGGT also said that due to the uncertainty about legislation at the time of setting the RIIO-T1 price control allowances, it had not requested funding for ongoing asset health costs or decommissioning costs of units affected by legislation.

NGGT also said that its 2015 reopener submission also included decommissioning and asset health costs, and that Ofgem did not raise any concerns at the time. It added that this meant that Ofgem has changed its position since 2015.

Finally, NGGT said that its proposed works at Carnforth-Nether Kellet is to decommission one unit at Carnforth and to integrate the site with Nether Kellet, which is the lowest cost option. NGGT said that if Ofgem did not provide the requested funding for decommissioning as part of this reopener, it would need to “reconsider whether [the unit] should be replaced”.

Our decision

Having considered responses to our consultation from NGGT and other stakeholders, we have come to a decision on all areas of funding requested by NGGT as part of this reopener. The rest of this section sets out our decision on each area, and our reasons for that decision.

St Fergus and Hatton

In our consultation document, we set out our initial view that there is uncertainty about the solutions that would deliver the most benefits for consumers, and that we would consider providing appropriate funding as part of the RIIO-T2 settlement as long as NGGT is able to justify the need for the investment, the solution chosen, and the level of efficient costs. We also said that if NGGT needs to incur expenditure at either St Fergus or Hatton during the RIIO-T1 period, we would consider providing appropriate funding as part of the close out process for RIIO-T1, provided NGGT is able to demonstrate that the expenditure was necessary, proportionate and efficient.

NGGT disagreed with our proposed approach to funding for these sites. It argued that there is sufficient certainty to provide funding at this stage, and highlighted the risks to NGGT and to consumers from delaying our decision until the next price control. We disagree with NGGT’s view on the certainty of solutions and costs at these sites.

In the case of St Fergus, NGGT is progressing two options to the next stage of internal financial approval – but we note that NGGT’s cost forecasts for the options are not significantly different from each other. One option involves carrying out emissions abatement work on two large gas compressor units, and the other involves carrying out emissions abatement work on one large gas unit and installing one new small gas unit. NGGT’s funding request is based on the forecast costs of the second (higher cost) option, but it has not made a final decision.

In the case of Hatton, NGGT is progressing one option, which involves installing one new large compressor unit, to the next stage of internal financial approval. However, NGGT intends to consider other options including fitting emissions abatement technology on existing compressors. In our view, it is possible that NGGT concludes that emissions abatement on existing compressors would be cheaper and a better solution than installing a new compressor unit.

We expect NGGT to keep its investment plans under review and deliver the most efficient solution for consumers. This does mean that NGGT’s early forecasts of the most efficient solution for compliance with emissions control legislation, and the associated costs, are sometimes substantially revised before the expenditure is actually incurred.

In its business plan submission for the RIIO-T1 price control, NGGT had forecast expenditure of £813m during the RIIO-T1 price control period across its network to comply with emissions control legislation. By the time of the 2015 reopener, this figure had been reduced to approximately £400m (for the RIIO-T1 period). By the time of the 2018 reopener, this had reduced further to around £200m (for the RIIO-T1 period). This is not necessarily a reflection on the quality of NGGT’s forecasting – there was, and continues to be, uncertainty around network flows, compression requirements and asset reliability – all of which can affect the choice of solution and costs. There was additional uncertainty during 2012 in relation to the precise requirements of emissions control legislation.

While we welcome this reduction in forecast expenditure, and consider this to be a positive development for consumers, we think that basing our funding decisions on NGGT's early forecasts exposes consumers to significant risks. We believe that our approach of mitigating this risk by delaying funding decisions until there is greater certainty through the reopener mechanism has delivered significant benefits to consumers.

The risk to consumers is further highlighted by NGGT's proposed regulatory outputs (to which we would hold NGGT accountable) at these sites. At St Fergus, its proposed output is "Emissions *compliance* on one Avon unit and one RB211 unit at St Fergus", and at Hatton it is "IED (LCP) emissions compliance at Hatton *equivalent to one large unit*".

We are mindful of the fact that there may be a number of ways in which emissions control compliance can be delivered, with significant differences between them in terms of their impacts on other aspects of the network. Any work carried out by NGGT for emissions compliance has knock-on effects on other aspects of the network that consumers value, such as future operating and replacement costs, system capability, and resilience.

The regulatory outputs associated with emissions control funding that we have set so far relate to compliance with emissions legislation – and not to the other aspects that consumers value. While NGGT's forecast expenditure may be based on one solution that complies with emissions control legislation, the actual solution delivered could be one that complies with emissions control legislation, but provides lower overall benefits to consumers than the option used to set allowances.

For instance, at Hatton, compliance with emissions control legislation (and the output as proposed by NGGT) could be delivered in a number of ways, e.g. by installing a new unit or by installing emissions abatement technology on an existing unit – with potentially significant cost differences between them. Installing a new unit provides an asset that could potentially be used for 50-60 years, fitting emissions abatement on an existing unit may lead to higher operating costs in the short term and may need part- or full replacement at an earlier date than would be the case if a new unit were to be installed.

For these reasons, we maintain our view that there is insufficient certainty about the solutions that NGGT will deliver at St Fergus and Hatton, and the associated costs. Providing funding now exposes customers to the risk that the actual solution delivered at these sites would be different to the ones set out in NGGT's submission, and provides lower overall value to consumers.

We acknowledge that NGGT may need to incur expenditure at these sites before the end of the current price control period (i.e. 31 March 2021) in order to ensure compliance with emissions control legislation. If we were to delay our funding decision to the end of the period, NGGT would face some uncertainty about whether funding would be provided then.

In this case, we think the appropriate way to address the risk to consumers and to provide greater certainty to NGGT is through a two-stage process:

- **Agree the needs case:** We would work with NGGT to agree the needs case for its preferred solution for emissions compliance at St Fergus and Hatton once it has made its final decision, and before it would need to incur expenditure on procuring long lead-time items.
- **Provide appropriate funding:** As part of our price control review for the next period (RIIO-T2), we would provide appropriate funding for efficient costs of the agreed solution. This would include costs incurred during the RIIO-T1 price control period.

Before agreeing the needs case, we would expect to see a formal submission from NGGT that sets out the following information for St Fergus and Hatton:

- An explanation of the needs case for investment, along with a clear statement of why the investment is needed for complying with emissions control legislation.
- A full specification of the final option to be delivered and timelines for delivery, including key milestones.
- A full cost benefit analysis to support the choice of solution, including details of alternative options considered.
- A detailed breakdown of the costs that are expected to be incurred to deliver that solution.
- The overall value to consumers that it expects to be delivered as a result of its chosen solution. This must include a statement of the expected impact of its solution on network capability, resilience, flexibility and long term costs.

Our assessment of NGGT’s submission would consider whether it demonstrates that:

- The proposed solution is triggered as a result of emissions control related legislation (in line with the definition of Industrial Emissions Costs in NGGT’s licence).
- Its proposed solution delivers the most long-term value for consumers through a detailed cost benefit analysis that considers a range of reasonable options.
- It sets out clear and unambiguous regulatory commitments on the value that would be delivered for consumers, taking account of factors such as site compression capacity, system resilience, flexibility and long term costs. This should be expressed in the form of regulatory outputs.
- A detailed forecast of the costs that is expected to be incurred in delivering its proposed solution (both during the RIIO-T1 and RIIO-T2 price control periods).

If we are satisfied with the needs case submission, we would provide formal written agreement of the needs case within a reasonable timescale. We would also set clear regulatory outputs for the two sites, setting out what we expect to be delivered for consumers. Again, the outputs and value for consumers may be expressed in terms of compression capacity, system resilience, flexibility and long term costs and timelines for delivery.

As part of its business plan submission for the RIIO-T2 price control, we would expect NGGT to set out its request for funding for efficient costs associated with the delivery of the agreed outputs at these sites. These may include costs incurred in the RIIO-T1 price control period as well as forecast costs for the RIIO-T2 price control. Should the funding request be materially different from the forecasts provided as part of the needs case submission, we would expect such differences to be justified.

As part of the RIIO-T2 settlement, we would provide funding for efficient costs (covering the RIIO-T1 period as well as the RIIO-T2 period) as assessed by us for meeting the outputs at St Fergus and Hatton.

We will hold NGGT accountable for the delivery of its outputs in relation to these two sites. In the event NGGT fails to deliver against these outputs, we reserve the right to either not provide the funding or claw back all or part of the funding provided. In doing so, we will consider the interests of consumers including the impact of non-delivery on the network – in terms of compliance with emissions control legislation, network capacity, resilience, flexibility and long-term costs. For the avoidance of doubt, we do not intend to claw back any underspends that are due to genuine efficiency savings.

We note the comment from Citizens Advice that waiting until the RIIO-T2 price control to make our decision on the needs case “*may not promote the most efficient management of the network*”. We think the approach set out above addresses these concerns.

We think that our approach provides the necessary clarity for NGGT and addresses the concerns raised by NGGT about uncertainty about Ofgem’s position and the risk that it “*will be unable to operate the [non-compliant units at these sites] beyond 2023 which introduces risk of network constraints*”.

Peterborough and Huntingdon

Our consultation document set out our initial view that additional funding should not be provided for these sites as part of this reopener. This is because we believe that NGGT has already been funded for the work that it is seeking funding for.

NGGT's response said that, in its view, the regulatory output for which funding has been previously provided should be considered as met by the installation of one new compressor unit at each site, and therefore the second unit at each site should be separately funded as part of this reopener.

In its business plan submission to Ofgem as part of the RIIO-T1 price control assessment in 2012, NGGT said that its proposed solution for emissions control compliance at Peterborough and Huntingdon was to install one new large 35MW VSD compressor unit at each site as part of what it referred to as IPPCD Phase 3 works. No other works were anticipated at these sites for compliance with emissions control legislation. In particular, no work was planned at these sites for IPPCD Phase 4 works. While we disagreed with the size of the proposed new units, we agreed that a large 24MW electric unit would be the right solution and provided funding for Phase 3 works at both sites on that basis. We also provided separate funding of £288m for Phase 4 works at other sites that NGGT had identified in its business plan submission (Alrewas, Diss and Wormington).

NGGT then undertook further analysis including a BAT assessment which concluded that the best solution at Peterborough and at Huntingdon was not one large electric unit, but instead three small 15.3MW gas units. NGGT subsequently revised its assessment to two small 15.3MW gas units at each site.

Our review of NGGT's reports to the EA and SEPA up to 2015 make it clear to us that NGGT was planning to install two units at each site as part of Phase 3 works. It was only in 2016 that NGGT started to split the two units at each site into two phases (although they were being delivered at the same time).

In the MPR Parallel Works Decision we said that we would not hold NGGT to account to specific compressor sizes or technologies, instead we would consider the output delivered if NGGT complies with the IED in a way that delivers the greatest value.

We maintain our view that the outputs set for NGGT at Peterborough and Huntingdon would only be delivered once the most efficient solution for emissions compliance at these sites have been delivered in full – and this is not affected by the number and sizing of units installed but by what could reasonably be considered to be part of IPPCD Phase 3 works. NGGT's own analysis had concluded (as set out in its report to the Environment Agency and Scottish Environment Protection Agency in 2015) that the most efficient solution for IPPCD Phase 3 compliance works at Peterborough and Huntingdon was to install three new small gas units at each site – not one large electric unit at each site as it originally said. The 2016 BAT reports for both sites concluded that the appropriate solution at each site was to install two new units.

We do not think NGGT should be able to access additional funding for delivering its outputs by simply splitting the work into different phases on paper, e.g. by splitting by two units at each site into IPPCD Phase 3 and Phase 4 works. This could lead to potentially perverse outcomes for consumers. Hypothetically, NGGT could decide to split the work further by phasing the planned emissions reductions at each site and seek additional funding for the later phases. This would be wholly inappropriate and would represent a bad deal for consumers as they could end up funding the same work twice. For all practical purposes, the work at each site is being done as a single project that was identified as the BAT solution. At each site, both units were procured at the same time and are being installed as part of a single programme of works at each site.

We acknowledge that NGGT had previously informed stakeholders and Ofgem of its plans for splitting the works into Phase 3 and Phase 4 outputs, both through its submission for the May 2015 reopener and through annual regulatory submissions (RRPs). However, we do not accept NGGT's contention that by not explicitly challenging these statements, we had somehow accepted or endorsed NGGT's view of the relevant outputs at these sites. We have not made any statements that we would provide additional funding for emissions control work at Peterborough and Huntingdon or that we considered any such work to fall within Phase 4. In the case of the 2015 reopener, we rejected NGGT's entire submission on the basis that it was not justified without expressly considering whether the proposed works fell within Phase 4. In the case of NGGT's annual regulatory submissions, while we do go through a process of challenging and questioning the information provided, we do not necessarily accept or endorse any of the information contained in it and our scrutiny of these submissions does not replace what we would do to assess a formal reopener submission.

The MPR and MPR Parallel Works documents were focused on whether NGGT's outputs needed to be changed, and how we intended to hold NGGT accountable for those outputs. We did not and have not expressed a view on whether NGGT has met its emissions control outputs. The final MPR Parallel Works report set out our interpretation of the emissions control output, and how we intend to hold NGGT to account for that output at the end of the current price control period. Any references we made in these documents to actual expenditure and performance against allowances were based on figures provided by NGGT, and were not intended to provide a view on whether regulatory outputs had been met. This does not preclude us taking a view now on whether additional allowances should be provided. We believe that our consultation on the 2018 reopener provided stakeholders with an opportunity to comment on our proposed approach to the outputs and funding at Peterborough and Huntingdon. One other respondent (Centrica Group) addressed this issue directly, and was supportive of our position.

We do not agree that the approach taken at the previous price control for funding Phase 1 and Phase 2 works at St. Fergus, Hatton and Kirriemuir is relevant to this decision. Under the RIIO framework, funding is linked to specific outputs to be delivered for consumers, whereas in previous price controls we did not set such outputs.

For the reasons set out above, we have decided to maintain the position set out in our consultation document, i.e. to not allow NGGT to retain the requested funding for these sites.

NGGT's response to our consultation suggests that it is now planning to install a third new gas compressor unit at both Peterborough and Huntingdon as part of its emissions compliance work, but this was not included in NGGT's 2018 reopener submission. We note that the BAT analysis report (dated 2016) that NGGT submitted to us as part of this reopener process only recommends installing two new units for IPPCD compliance. NGGT's consultation response suggests that the third unit is needed as part of its strategy for compliance with the MCP Directive, which currently has a compliance date of January 2030. We will consider whether to provide any additional funding for NGGT to install a third unit for MCP compliance as part of future price controls.

Other sites

On NGGT's funding request for the remaining sites, our consultation set out our initial view that the proposed works at all but one site are not driven by emissions control compliance, and therefore do not qualify for funding as part of this reopener. We proposed to allow funding of £0.53m for work carried out by NGGT at Wisbech.

At Carnforth, Warrington and Kirriemuir, NGGT had proposed to decommission compressor units. However, as set out in our consultation document, every compressor that NGGT proposes to decommission is already compliant with emissions control legislation, as long as the conditions of compliance in terms of running hours are met. NGGT's own forecasts

show that running hours for these units are forecast to be very low, and to not exceed the relevant limits. One of these units (at Kirriemuir) has not been operational since 2016 and is currently already disconnected from the network.

At Carnforth, in addition to decommissioning two compressor units, NGGT proposed to carry out some work to partially integrate the site with Nether Kellet, thereby enabling the units at Nether Kellet to act as back up for the remaining unit at Carnforth. While this may be the right decision from an operational perspective, we did not believe that this is necessitated by emissions control legislation.

At Moffat, NGGT had proposed to carry out asset health works to keep two compressor units operational in the short term. These units were installed in 1980 and are nearing the end of their lives, and they currently benefit from derogations from emissions control legislation. The units are running at very low levels and NGGT has concluded that the site is no longer required and has been identified for decommissioning in the future.

For these reasons, we were not convinced by NGGT's reopener submission that these works are required to comply with emissions control legislation.

NGGT's response argued that Ofgem had previously accepted that compliance with emissions control legislation could be delivered through "*decommissioning, retrofitting, exchange of non-compliant turbines etc*". We do not dispute that these solutions could be used by NGGT as part of its strategy for compliance with emissions control legislation, and in some cases may be the most efficient solution. However, in the specific instances covered by NGGT's reopener submission, we do not think that emissions control legislation requires the work to be carried out.

Given this, we maintain our view that these works should not be funded as part of this reopener. For the avoidance of doubt, we are not suggesting that any of the works proposed are not required – that is a decision for NGGT to make.

NGGT also said that due to the uncertainty about legislative requirements at the time of setting the RIIO-T1 price control allowances, it had not requested funding for ongoing asset health costs or decommissioning costs of units affected by new legislative requirements. We do not think this is a reason for funding works through this reopener that are out of its scope. NGGT was provided ex ante funding for asset health works as part of the RIIO-T1 package. It is up to NGGT to manage the risks and requirements on its network using the totex allowances and specific adjustment mechanisms provided. We do not think we should revisit this policy area as part of this reopener, particularly in an asymmetric way that targets areas where NGGT may have incurred unexpected expenditure while leaving other areas unchanged. We think doing so would be detrimental to the interests of consumers and would harm the integrity of the price control.

NGGT also said that its 2015 reopener submission also included decommissioning and asset health costs, and that Ofgem did not raise any concerns at the time. As set out previously, we rejected NGGT's 2015 reopener in its entirety. Given this, we do not agree that we had endorsed or agreed with individual solutions proposed in that submission.

For the reasons set out above, we maintain the position set out in our consultation document to not allow NGGT to retain the funding requested for these sites.

Finally, NGGT's response said that if Ofgem did not provide the requested funding for decommissioning two units at Carnforth as part of this reopener, it would need to "*reconsider whether [one of the two units at Carnforth] should be replaced*". NGGT's submission said that the best approach from a network operational perspective is to decommission two units and partially integrate the site with Nether Kellet by carrying out relatively minor modifications at the site at a total cost of £3.2m. It is not clear how NGGT could justify progressing a more expensive option (i.e. installing a new unit at Carnforth *without* integration with Nether Kellet) unless there is a change in network requirements. If

it did so without proper justification, we would need to consider appropriate action to ensure that customers are not exposed to demonstrably inefficient and wasteful costs.

Our views on general issues

We note the concerns expressed by one respondent that the volume and complexity of the material included in our consultation documents (across all reopeners) made it difficult to fully engage with the issues raised within the consultation period. We are sympathetic to these concerns, but the consultation period was constrained by the timeframes set out in the relevant licence condition which require us to make a decision by the end of September. We would also point out that we had published the submissions received from companies shortly after they were received in May, allowing stakeholders additional time to review the relevant background and justification provided by the companies. We also encouraged stakeholders to contact us if they required further clarification, and we held discussions with those stakeholders who had contacted us in this regard. As part of this process, we also discussed our views with the EA and SEPA.

A number of respondents queried whether we had taken account of the implications of our funding decisions on network capability, resilience and flexibility. Where appropriate, we have done so. In the case of the emissions compliance reopener, we were clear that it is NGGT's responsibility to ensure that it operates and maintains the network in accordance with its regulatory obligations, which includes taking account of network capability, resilience and flexibility. The reopener was set up with a narrow focus, i.e. to provide funding for work required to comply with emissions control legislation. The overall RIIO-T1 price control settlement provided the funding for NGGT to comply with its other obligations, and it would not be appropriate for us to reopen the other aspects of the price control as part of the emissions reopener.

We note NGGT's comment about its previous stakeholder engagement, and its claim that our reopener decision could risk alienating stakeholders. We also note NGGT's claim that stakeholders had supported NGGT's proposed emissions compliance work. We welcome NGGT's efforts to engage with stakeholders and value stakeholders' inputs into our decisions. However, we do not agree that our assessment of NGGT's reopener submission undermines this stakeholder engagement or the support they may have given. Our assessment has focussed on whether additional funding should be provided as part of the reopener, we have not expressed a view on whether NGGT should carry out any of the works it has proposed. We do not think that our decision on NGGT's request for additional funding for emissions compliance should compromise NGGT's ability to deliver an efficient and reliable network for consumers.

Finally, we note the concerns expressed by one respondent about the disagreement between Ofgem and NGGT on the baseline allowances that were provided as part of the RIIO-T1 settlement. Our RIIO-T1 Final Proposals clearly set out the baseline uncertain allowances for emissions compliance (£269.3). However, this did not include adjustments for real price effects (RPEs) and our information quality incentive (IQI). The actual allowances provided in NGGT's licence (through the price control financial model) includes these adjustments – which in our view takes the total allowance to £288m. We acknowledge that the final allowance for emissions compliance was not explicitly set out in the financial model, it was added to other baseline allowances and expressed as an aggregate amount. However, having reviewed the original calculations, we are satisfied that the final allowance provided for uncertain emissions compliance costs was £288m. As part of our assessment of NGGT's submission, we asked NGGT to explain the basis for its view of baseline allowances. NGGT told us that its figures only adjust for RPEs, and not the IQI. We think this explains the difference between the two sets of figures, and we are satisfied that the IQI adjustment should apply. For these reasons, we maintain our view that the total baseline uncertain allowance provided was £288m.

Next steps

Our decision on NGGT's application for funding adjustments under this reopener will be implemented through the 2018 Annual Iteration Process, which will mean that any adjustments to NGGT's allowed revenues will take effect from 2019/20. Our final view on the adjustments is set out in the table below.

£m 09/10 prices	13/14	14/15	15/16	16/17	17/18	18/19	19/20	20/21	Total
Baseline uncertain allowance (Pre IQI and excl RPE)	-	1.605	16.044	48.097	64.066	63.615	44.230	31.648	269.303
Baseline uncertain allowance (Post IQI and incl RPEs)	-	2.334	17.139	50.458	67.907	67.891	47.505	34.750	287.983
Ofgem final view on allowances	-	-	0.53	-	-	-	-	-	0.53
Ofgem final view on adjustment to allowances	-	-2.334	-16.609	-50.458	-67.907	-67.891	-47.505	-34.750	-287.453

Our decision on St Fergus and Hatton is to delay our funding decision until there is greater certainty about the proposed solutions and costs at these sites. Earlier in this letter, we set out our approach to providing greater certainty for NGGT by agreeing the needs case before it proceeds to deliver its chosen solution at these sites.

We note that NGGT plans to make a final decision on the solutions that it would deliver at these sites by January 2019. We will work with NGGT in the coming months to agree a timeline for submission of the needs case for St Fergus and Hatton. Any funding would be provided as part of the RIIO-2 price control. For the avoidance of doubt, this process would only cover work and costs at St Fergus and Hatton that are required to be incurred during the current price control period as a consequence of emissions control legislation, in line with the definition of such costs set out in NGGT's licence.

Please contact Kiran Turner (kiran.turner@ofgem.gov.uk) if you would to discuss any aspect of this letter.

Yours faithfully,

Geoffrey Randall
Deputy Director, Gas Network Price Controls