



A35 - NGN RIIO-2

RIIO-2 Challenge Group
You Said, We did Responses

together
**we are
the network**

Introduction to this document

The RIIO-2 Challenge Group's detailed review of the previous draft of our business plan has been extremely valuable in helping us to strengthen our final submission. This brief supplement highlights those areas where RIIO-2 Challenge Group feedback has resulted in changes to the latest version of the plan.

We have presented this information in a 'you said, we did' format: highlighting the RIIO-2 Challenge Group's feedback, and how we have changed and strengthened our business plan in response.

As ever, we are extremely grateful for the insight, challenge and support the RIIO-2 Challenge Group has provided during this review process, which has contributed to an even more focused and ambitious plan for the future.

1. Track Record

RIIO-2 Challenge Group Assessment of V2 Business Plan

Green

The challenge

The plan explains the transition from RIIO-1 to RIIO-2, how efficiency savings have been carried over and how innovation has been deployed from RIIO-1 to RIIO-2.

NGN Assessment (based on response to feedback)

Green

Our response

Our baseline RIIO-2 cost forecasts include the efficiency and innovation savings we have delivered in RIIO-1. These will set the efficiency frontier. The annual efficiency savings for RIIO-2 included in our plan are challenging from this baseline.



Part 2.1 – Our performance in RIIO-1

2. Business Plan Commitment

RIIO-2 Challenge Group Assessment of V2 Business Plan

Red

The challenge

Business Plan Commitment. This is not expected to be complete until submission of the December plan.

NGN Assessment (based on response to feedback)

Green

Our response

We have now addressed this component of the business plan Guidance in Part 2 of our business plan.



Part 2 – Giving customers confidence that we will deliver

3. Stakeholder Engagement

RIIO-2 Challenge Group Assessment of V2 Business Plan

Green

The challenge

This is a thorough and well-articulated approach to stakeholder engagement. Its impact on the plan is well evidenced and the level of acceptability recorded is high.

NGN Assessment (based on response to feedback)

Green

Our response

N/A

You say you are making a £3m 'cost commitment' to stakeholder engagement over the course of RIIO-2. Can you clarify whether this includes all costs, whether these are all part of your baseline costs, and what steps you have taken to ensure this represents value for money.

We have clarified that these are all costs. They are incorporated into our operational expenditure proposals. We have tested our approach with stakeholders to ensure that they feel it represents value for money. In particular, we discussed the approach, including costs, with our Citizens' Jury who supported this level of investment.



Part 3.4 – Moving forward, together – Our approach to stakeholder engagement for 2021-2026

Appendix A4 - NGN RIIO-2 Stakeholder Engagement Insights (Insight 5)

Please also clarify how your forward engagement strategy will support biomethane stakeholders.

We have specifically clarified how we will engage with biomethane stakeholders and the mechanisms that we will use to do so.



Part 3.4.2 'Engaging with Biomethane Stakeholders)

You say that staff rewards will be 'linked to delivery of commitments in the plan'. Set out how any annual and long-term bonuses at all levels in the business will be linked to delivery, and what weighting is given to non-financial outcomes.

This has been added into the plan.



Part 2.1.8 – Aligned pay and reward to support business plan commitments

4. Outputs

addressing customer vulnerability

RIIO-2 Challenge Group Assessment
of V2 Business Plan

Amber

The challenge

Further information has been provided to fill some of the gaps identified in the July plan. The plan should show how totex forecasts map onto ODI's and PCD's.

Overall approach is promising, outputs are well evidenced on the whole and with a qualitative articulation of benefit. A fuller articulation of value for money or costs could push the score to Good. The table on p89 sets out benefits, but generally there is currently little discussion of cost or value for money. We note that quantification of benefit is to follow in December


Actions relating to the Consumer vulnerability reputational incentive (annual showcase and reporting) are missing from the plan. Without these measures this area would score as Red/incomplete because this is a required deliverable.

NGN Assessment
(based on response to feedback)


Green

Our response


Summary tables are provided for each vulnerability output and forecast costs have been mapped for each output where possible. It is not always practical to separately map individual cost items/lines to every output.

 Part 4.2.3 – Helping those who need it most, Tables 4.8 and 4.9
Appendix A6 - NGN RIIO-2 Outputs
Appendix A7– NGN RIIO-2 Vulnerability Strategy

Each output now has a range of benefits qualified for where we consider that benefit will be realised. We have also monetised where possible the benefit that will be delivered in RIIO-2 for many of the outputs using information gained from our WTP engagement and Customer Value Proposition benefit assessment.

 Part 4.2 – Meeting the needs of Customers and network users, Tables 4.1 to 4.24
Appendix A6 – NGN RIIO-2 Outputs
Appendix A7 – NGN RIIO-2 Vulnerability Strategy
Appendix A13 – NGN RIIO-2 Customer Value Proposition

A reputational output has been included for an annual showcase event and annual report within Part 4.2.3 – Helping those who need it most, Table 4.9


 Part 4.2.3- Helping those who need it most, Table 4.9
Appendix A7 – NGN RIIO-2 Vulnerability Strategy

The plan does not articulate a partnership or a multi-agency approach.

Our approach in RIIO-1 has been based on a multi-agency approach and our RIIO-2 plan continues this approach. We have demonstrated a multi-agency approach to addressing customer vulnerability within s4.2.3 of our Plan and expanded upon in Appendix A4 -Vulnerability Strategy. The framework for our strategy has been building on learning from RIIO-1 and feedback from our stakeholders and recognises the benefits of partnership working. Key initiatives that will be delivered via a multi-agency approach include:

- The Hardship Fund - every aspect of this scheme will be delivered through partnership working.
- Community Partnering Fund - has been developed and delivered with Leeds Community Foundation and Northern PowerGrid. It has attracted many community groups and associations from which we have developed formalised partnerships.
- Customer and Social Competency Framework - Has been developed with National Energy Action and will be accredited by the Institute for Customer Service. The training will be delivered through a mix of in-house and external partners, dependent on the subject and level of expertise required.

We also outline a joined-up approach for delivering vulnerability initiatives through our Whole System Strategy. A specific outcome of the “solutions and services” enabler is to work with other stakeholders to deliver Vulnerability Initiatives such as the community partnering fund.

 Part 4.2.3 – “Helping those who need it most”
Appendix A7 – NGN RIIO-2 Vulnerability Strategy
Appendix A14 – NGN RIIO-2 Our Whole Systems Strategy

The target of 1,000 fuel poor connections is not very ambitious. NGN have reflected this and now have a stretch target of 2000 which is an improvement. We note you will only claim the full value of the award if you can prove the home is more energy efficient once connected to gas which is a welcome proposal but needs a fuller explanation in the plan as it is not clear how NGN will assess and operate this.

Our target will be to connect as many Fuel Poor customers as possible during the RIIO-2 period, but with a minimum target of 1,000 customers p.a.. Within our stretch target, those connections completed as part of Community Schemes, we will undertake an assessment to understand how much more energy efficient these homes are once connected to gas. We will use the Standard Assessment Procedure (SAP) rating as the base for this assessment and propose that we should demonstrate a 3 point or greater improvement to the SAP rating.

The Standard Assessment Procedure (SAP) is the methodology used by the Government to assess and compare the energy and environmental performance of dwellings. Its purpose is to provide accurate and reliable assessments of dwelling energy performances that are needed to underpin energy and environmental policy initiatives

If we are unable to reach this SAP rating improvement on community schemes, we will make a self-imposed penalty payment based on the average savings delivered by reaching a 3-point SAP improvement, compared to the savings delivered when this isn't reached. Calculations to support this approach are provided in the Vulnerability Appendix.

The penalty payment will either be made directly to fund further energy efficiency improvements or to supplement the existing Hardship Fund. The approach will make sure that we deliver maximum benefits to customers receiving a connection under FPNES.



Part 4.2.3 – Helping those who need it most
Appendix A7 – NGN RIIO-2 Vulnerability Strategy

Customer Satisfaction, GS, complaints, emergency response etc.

RIIO-2 Challenge Group Assessment of V2 Business Plan

Red

NGN Assessment (based on response to feedback)

Green

The challenge

Some aspects of this section are good, including your plans for how you will restore service during unplanned interruptions. Some of the bespoke incentives are also encouraging, however you have not yet provided evidence of whether they are supported by stakeholders (including your CEG). As this is unfinished, we cannot give more than a Red rating overall in this area.

Our response

Customer insights have been mapped to evidence each specific output in Part 4 and a cross reference to each specific customer insights in now included within the summary tables for each output. An overview of how customer insight helped to inform the development of outputs in provided in Part 3.3 and the involvement and approval of outputs by our CEG in Part 3.2.

Part 4.2– Meeting the needs of Customers and network users - Tables 4.1-4.22

Part 3.3 – Together we have created a plan for the future

Part 3.2 – Collaboration and challenge

Appendix A4 – NGN RIIO-2 Stakeholder engagement insights.

Appendix A6 – NGN RIIO-2 Outputs



On customer satisfaction, you say you want to achieve 'industry leading scores. As Ofgem is setting the targets here and your ambition is to achieve industry-leading performance, how do you see this being reflected in the regulatory framework and being held to account for this? Please also provide a cost benefit analysis to demonstrate that your customer service costs represent good value for money: although costs are not increasing, they are still significant.

We consider that the regulatory framework will establish the minimum levels of service that are expected by Customers and we will deliver our RIIO-2 activities to outperform these. We are supportive of a dynamic measure, that constantly stretches us to achieve increased performance. We have been instrumental in leading the GDNs to develop a better customer satisfaction framework for RIIO-2, which included independent research in 2016, and then a series of trials 2017-9, which have culminated in the design of more customer focussed questions, and a methodology that better meets the needs of our customers.

We have self-imposed higher financial penalties in the event of non-delivery of many outputs and consider this will drive improved performance as these are paid by our owners.

Since 2013 we have used the Institute for Customer Service Benchmarking Survey – ServCheck to understand how we are performing both within and outside our sector. Through this measure we are recognised as industry leading and consider this method of assessment as best practice. We have committed to continue with this during RIIO 2.

We have introduced a formal framework for conducting non-regulatory customer satisfaction surveys and have proposed a reputation incentive that will measure our ability to listen to and respond to feedback given by customer groups who are not included in the regulatory surveys.

Costs and benefits have been assessed and qualified for each output. Our assessment of benefit has been informed by the outputs of our WTP and our CVP analysis assessment and show that there is a positive net benefit from our proposal for customers.

Part 4.2– Meeting the needs of Customers and network users - Tables 4.1-4.22

Part 4.2.1 – A truly great customer experience for everyone



Part 4.5 – Our Customer Value Proposition

Appendix A6 – NGN RIIO-2 Outputs

Appendix A13 – NGN RIIO -2 Customer Value Proposition

BPDT – Outputs, CVP and UM snapshot table

Maintaining safe and resilient network

RIIO-2 Challenge Group Assessment of V2 Business Plan

Amber

NGN Assessment (based on response to feedback)

Green

The challenge

Further information has been provided to fill some of the gaps identified in the July plan. We note that NGN first transferred maintenance to a contractor and now bought it back in-house – the plan should explain any implications to system resilience in terms of staff competence in this area.

Our response

NGN regularly cycle insourcing and outsourcing to improve efficiency but also access skills and adopt best practice from the wider market. This increases long-term resilience. Insourcing maintenance enables benefits derived from the original outsourcing to be fully embedded. The decision to insource maintenance was risk assessed and ensured that NGN can embed resilience into its workforce and retain the competences required to take the business forward.



Part 4.3 Workforce Resilience

Appendix A10 – NGN RIIO-2 Workforce Resilience Strategy

During RIIO-2, new regulations to ban gas boilers in new houses will come into force, impacting IGTs and gas engineering resources. At the same time, expertise may be needed for development of hydrogen. What are the resourcing implications and how do you plan to address them?

In the RIIO-2 period we are likely to experience an increase in demand for gas connections as the implementation date for new regulations approaches. We will be able to cater for this increase with existing resources.

We are aware of the future challenges associated with gas boilers and our role in facilitating the transition of the network to potentially deliver Hydrogen in place of Methane. As a part of our Workforce Resilience Strategy, two of our key priorities are to maximise investment in skills, in addition to taking targeted action to increase our future talent pool.

We have key objectives and deliverables under each of these priorities, including the NGN development centre, but we will also look to the market to help mitigate wider resilience risks and ensure that we can embed the necessary skills to manage this risk.

Key work that we are planning under Phase 3 of our H21 work program is the development of a "Hydrogen Training Scheme" which will ensure that we have a fully trained and competent workforce that is able to perform the conversion process and business as usual activities (e.g. maintenance, connections, disconnections etc.) on a hydrogen network.

This project will create a hydrogen training scheme that can be utilised by all of the UK gas distribution network workforces.



Part 4.3 Workforce Resilience

Appendix A10 – NGN RIIO-2 Workforce Resilience Strategy

Delivering an environmentally sustainable network

RIIO-2 Challenge Group Assessment of V2 Business Plan

Amber/ Red

The challenge

There has been some good progress since July, including preparation of your EAP with some clear targets and good ambition, for example on aggregates and supply chain. However, we have had to rate the EAP and environmental section of your plan as less than adequate because we feel it has minimal coverage of intended contribution to transition to low carbon (one of the three impact areas which EAPs are expected to cover), with very little indication of concrete action in relation to biomethane, in particular, to suggest that you will be facilitating and being proactive rather than reactive.

NGN Assessment (based on response to feedback)

Green

Our response

We have changed the layout of our business plan document and EAP to clearly demonstrate how we meet each of the three EAP impact areas required in the business plan guidance, in particular our role in supporting the achievement of net zero. We also present proactive actions to make our biomethane customer service cheaper, faster and more efficient.



Part 4.4 – Delivering an environmentally sustainable network

Appendix A8 – NGN RIIO-2 Environmental Action Plan - Part 6

In relation to carbon reduction you have made a commendable effort to include science-based carbon reduction targets and actions to achieve these targets are set out with reasonable clarity, but there does not seem to have been any reconsideration of ambition in the light of the 2050 net zero decision.

We have revisited our existing science-based carbon reduction targets and refined these to ensure they are consistent with and deliver net zero emissions by 2050. These more ambitious carbon reduction targets have been adopted as our business carbon footprint targets for RIIO-2 with the objective of our achieving zero Scope 1 and 2 carbon emissions (excluding shrinkage) by 2030/31. Our RIIO-2 carbon reduction targets for RIIO-2 will reduce our Scope 1 and 2 emissions by 52% and Scope 1, 2 and 3 emissions by 28% vs our 2017/18 baseline.



Part 4.4.1 – Reducing our business carbon emissions.

Appendix A8 – NGN RIIO-2 Environmental Action plan Part 6

Plans for commercial fleet replacement do not seem to allow for the likelihood of technological change during the RIIO2 period and targets for reduction in scope 1, 2 and scope 3 emissions in the RIIO 2 period seem relatively unambitious.

We have added further details to part 6 of our EAP identifying how our vehicle fleet is intrinsic to our ability to operate a safe and reliable network with excellent customer service. Any changes to our vehicle fleet, in particular our commercial vehicle fleet, need to be carefully considered to ensure that we maintain a robust, flexible and resilient fleet of vehicles which enable us to operate our network safely and effectively for our customers.

Our vehicle replacement investment plans have advanced since Draft V2 of the business plan submitted in October 2019. We are now targeting at least 50% of our total vehicle fleet (cars and commercial vehicles) being ultra low emission or hybrid by end RIIO-2, reducing our annual vehicle carbon emissions by 30% in 2025/26 vs our 2017/18 baseline, delivering a cumulative saving of c.4240tCO₂-e over RIIO-2. We consider these to be ambitious vehicle fleet decarbonisation targets. Our EAP now confirms our commitment to continuously review the low emission alternatives available on the market when investing in any new commercial vehicles via our value framework assessment approach to ensure that we are flexible to technological advancements and challenging ourselves to decarbonise our fleet. We have also established fleet decarbonisation targets for our key contractors (mains replacement and reinstatement). These targets will be communicated with our contractors and their performance against these targets measured and monitored and support provided as necessary.

As detailed above, since Draft V2 submission we have revisited and refined our Scope 1, 2 and 3 carbon reduction targets to ensure they deliver net zero emissions by 2050. These more ambitious carbon reduction targets have been adopted as our business carbon footprint targets for RIIO-2 with the objective of our achieving zero Scope 1 and 2 carbon emissions (excluding shrinkage) by 2030/31. Our RIIO-2 carbon reduction targets for RIIO-2 will reduce our Scope 1 and 2 emissions by 52% and Scope 1, 2 and 3 emissions by 28% vs our 2017/18 baseline.



Part 4.4.1 – Reducing our business carbon emissions

Appendix A8 – NGN RIIO-2 Environmental Action Plan Part 6

Both the environmental section of the plan and the EAP would benefit from clearer summaries of actions and related costs in key areas.

The EAP initiatives costs have been more clearly identified in part 4.4.

Tables 9 and 13 have been added to the EAP specifying the costs and benefits of each EAP initiative.



Part 4.4 – Delivering an environmentally sustainable network – Table 4.20, 4.21 and 4.22

Appendix A8 – NGN RIIO-2 Environmental Action plan Part 6, Tables 9 and 13

5. Digitalisation strategies

RIIO-2 Challenge Group Assessment of V2 Business Plan

Amber

NGN Assessment (based on response to feedback)

Green

The challenge

You have described investments in digital in RIIO1 (e.g. PE asset health- avoids £4m costs), £5m planned spending on IoT in collaboration with ENA. Data driven decision making approach in innovations section appears good, investments seem reasonable. Good use of digital catapult and nice to see early examples of engaging with SMEs. However, the plan could show even more ambition in exploiting digitisation, and could do more on digital culture/capabilities.

Our response

We have included a comprehensive strategy, attached as an Appendix A12 to the business plan to outline our approach to digitalisation and the culture and capabilities that we have embedded in the business to maximise value from our approach. We have also included Part 4.6 which discusses our approach to modernising data and cost savings and efficiencies we have already realised in RIIO-1.



Part 4.6 – Modernising data

Appendix A12 – NGN RIIO-2 Digitalisation Strategy

What are your plans to use smart meter data to improve network planning and possibly identify capacity and also opportunities to reduce gas pressures (and leakage)?

We are committed to supporting the Smart Metering Implementation Programme, and we are working closely with other GDNs, Suppliers and BEIS to help ensure a safe and efficient rollout. We are also signatories of the Smart Energy Code (SEC), and fully comply with all our obligations. Smart meters are capable of collecting a large amount of data, specifically around consumption.

We fully recognise the potential benefits of smart metering data in developing our capabilities. However, there are a number of challenges at present to the full deployment of smart data into our processes, including cost of access to the DCC which will incur a cost of £8m over RIIO-2 and penetration levels of SMETS2 meters across our network.

As part of our Digitisation Strategy we are dedicated to developing a smart network of interconnected and inter-operable devices. We see this as a vital part of not only our own internal operations, but also of a national smart grid infrastructure covering the energy and transport sectors, and

beyond. Smart Meters are a great step towards that smart grid, but in isolation they will not provide enough benefit to NGN to justify the cost



Appendix A12 – NGN RIIO-2 Digitalisation Strategy

Appendix A18 – NGN RIIO-2 Innovation Strategy

Part 5.4 – Driving efficiency through innovation and competition.

6. Enabling whole system solutions

RIIO-2 Challenge Group Assessment of V2 Business Plan

Amber

NGN Assessment (based on response to feedback)

Green

The challenge

The plan proposes a Whole Systems Strategy which contains some useful initiatives, but the supporting appendix has not been provided. It is hoped the December plan will include more detail. No mention is made of the implications of heat pumps, and hydrogen pathways are unclear.

Our response

We have provided Our Whole Systems Strategy as Appendix A14. This document includes our pathway through to net zero by 2050, including consideration of heat pumps and hydrogen pathways among other key considerations we have had in relation to developing our pathway to 2050.



Part 5.1 – Enabling whole systems energy solutions

Part 4.4.2 – Supporting a net zero future

Appendix A8 – NGN RIIO-2 Environmental Action plan

Appendix A14 – NGN RIIO-2 Our Whole Systems Strategy

There is some evidence that Net Zero is causing a significant shift towards heat pumps for new commercial buildings and away from gas, particularly in cities. Is this something you are seeing and what are the implications for your assets?

We have modelled the impact of heat pumps through our forward demand planning and project that the uptake of heat pumps could be a significant factor in reducing gas demand in the future. Specifically, we are forecasting a 46% reduction in gas delivered through our network by 2050. We are not including specific investment for heat pumps in our RIIO-2 plan, however, we are supporting the work being undertaken by WWU on Freedom Project and implementing learnings where applicable. We also support fuel poor customers who want to connect to our network to make the most efficient choice when they connect to our network by providing an assessment of the most efficient and reliable heating source, which includes heat pumps. We also note that despite a forecast reduction in total gas delivered by 2050, our network will still be relied on to supply peak energy needs.



Part 5.1 – Enabling whole system energy solutions

Appendix A14 – NGN RIIO-2 Our Whole Systems Strategy

Appendix A16 – NGN RIIO-2 Economic Outlook

How have you engaged on biomethane with your customers? For example, to reduce the cost of biomethane injection and ensure efficient use of biomethane in the gas system?

We engage directly with our Biomethane producers and facilitators and enhanced this through the RIIO-2 process. We heard that our stakeholders are generally positive about our biomethane connections processes, operations and customer service, although they would like to see continuous improvement.

Stakeholders expressed divergent views on a range of topics such as our approach to shrinkage and shaping the biomethane market through Green Gas Certificates; ways to guarantee sources of supply; future network capacity; and scope for a biomethane injection hub.

In what is still an emerging sector, the nuances in perspective observed from individual producers and their distinct needs merits ongoing engagement and annual reporting on the metrics they value most - biomethane injection, volume of new connections and low carbon initiatives.

Part 4.4.2 – Supporting a net zero carbon future

Appendix A4 - NGN RIIO-2 Stakeholder Insights



Appendix A8 - NGN RIIO-2 Environmental Action Plan

Appendix A14 - NGN RIIO-2 Our Whole Systems Strategy

7. Managing Uncertainty

RIIO-2 Challenge Group Assessment
of V2 Business Plan

Amber

The challenge

Your plan sets out uncertainty mechanisms which include reopeners for streetworks, cyber, Large load connections, Rail diversions, physical security, smart metering, etc. Volume drivers/indexation are proposed for Tier 2a repex, fuel poor connections, and RPE. Please set out the potential costs associated with these and justifications for any additional uncertainty mechanisms to those proposed in Ofgem's planning guidance.

We would welcome more information on how you have determined the potential cost and impact implications of these risks and how they have been allocated between consumers and your company.

NGN Assessment
(based on response to feedback)

Green

Our response

Appendix A15 contains a full analysis of the primary risks affecting our business plan and the additional Uncertainty Mechanisms we believe are needed over and above those proposed by Ofgem. This analysis answers the 10 questions posed by Ofgem in their Business Plan Guidance for each proposed mechanism. This is then summarised in Part 5.2 Managing Uncertainty.



Part 5.2 Managing uncertainty

Appendix A15 – NGN RIIO-2 Uncertainty and Risk

We have carried out desktop analysis with internal experts to analyse likely outcomes both in terms of cost and output delivery. Only areas where the cost implication is more than 0.5% of totex in any year have been considered for a mechanism. Each proposed mechanism is detailed in Appendix A15 and is tailored to manage the risk between Customers and NGN.



Part 5.2 Managing uncertainty

Appendix A15 – NGN RIIO-2 Uncertainty and Risk

8. Driving efficiency through innovation and competition

RIIO-2 Challenge Group Assessment
of V2 Business Plan

Amber

The challenge

Innovation – the innovation area includes management initiatives to gain efficiency savings and a contains a wide range of potential initiatives, and how these will be approached. The plan does not clearly explain how innovation will deliver benefits to consumers in RIIO-2 and beyond. What innovation have you identified from other similar companies (e.g. EU based) that could be brought to the UK?

Efficiency – while there is a commitment to make a 0.5% annual cost efficiency reduction. RPE increases are not yet included. Please explain why you have not included a higher efficiency reduction in your plan given the innovation and efficiency initiatives you have already captured.

Competition – there is little information provided on native and early/late competition, with the plan stating that no projects fit in the £50m threshold. Effective procurement appears to be embedded within the plan, but please demonstrate how it will be applied to benefit consumers.

NGN Assessment
(based on response to feedback)

Green

Our response

Our baseline RIIO-2 cost forecasts include the innovation savings we have delivered in RIIO-1. These will set the efficiency frontier. Innovation will support the achievement of £20m of additional efficiency savings in RIIO-2.



Part 5.4 – Driving Efficiency through Innovation

Our baseline RIIO-2 cost forecasts include the efficiency and innovation savings we have delivered in RIIO-1. These will set the efficiency frontier. The annual efficiency savings for RIIO-2 included in our plan are challenging from this baseline.



Part 6 – Delivering value for money

A native competition plan is included in part 5.5 which builds on the approach we have taken in RIIO-1 in utilising competition to drive efficiency. Procurement efficiency is embedded in our baseline cost forecasts and will contribute to future RIIO-2 efficiency savings.



Part 5.5 -Driving efficiency through competition

9. Forecasting, scenarios and net zero

RIIO-2 Challenge Group Assessment of V2 Business Plan

Amber

The challenge

While two scenarios are developed, there is little impact shown on NGN investment plans e.g. any deferment of expenditure

NGN Assessment (based on response to feedback)

Green

Our response

In developing our capex and repex forecasts, we have assessed all scenarios against a baseline position. This is the “do nothing” option which demonstrates the impact of a reactive only policy of maintenance and repair. We have compared this baseline position against a range of scenarios that involve capex and repex spend in RIIO-2 and used our best practice asset investment planning processes and systems to optimise the most cost beneficial and practical areas to focus our expenditure whilst ensuring service levels are maintained.

In assessing our scenarios against this baseline position, we have specifically assessed the potential to defer capex to RIIO-3. The investments that we are proposing to deliver in RIIO-2 have been assessed using this proactive/ reactive investment trade-off (including consideration of refurbishment, which extends the life of assets further deferring the need for replacement) as well as considering the option to defer investments to RIIO-3.

We consider this approach is both prudent and in the long-term interests of our customers as it manages the uncertainty around the future role of gas networks as we work towards achieving our net zero emissions target as well as ensuring that in the short term, service is maintained.

We have in a number of areas chosen to defer traditional asset replacement expenditure to beyond RIIO-2 and increased the use of shorter-term interventions to manage asset risk. This will allow us greater time to assess the impact of Net Zero policy decisions on gas and limit the long term impact on bills.

We have also proactively considered the uncertainty associated with future gas demand and gas composition through our network (e.g. uncertainty associated with the potential conversion of our network over to hydrogen) in the development of our investment scenarios. Our chosen programme represents value for money over a 20 year period and is mainly driven by customer benefits such as avoiding loss of supply, safety considerations and avoiding increasing disruption from repairs due to deteriorating assets. The investments also ensure that we are compliant with relevant legislation. Therefore, it represents a no regrets investment

programme in RIIO-2, that will deliver value to customers whilst protecting them from the bill impacts of asset investments that may not be required in the longer-term.



Part 6 – Delivering value for money

The plan proposes a flexible framework for engaging with Net Zero. The plan provides little information to suggest that a pathway to Net Zero has been considered in any detail.

We have provided our pathway to net zero in Part 4.4.2 of our business plan. This is also discussed in further detail in Appendix A14.



Part 4.4.2 – Supporting a net zero carbon future
Appendix A14 – NGN RIIO-2 Our Whole Systems Strategy

Have you considered any projects for injection of hydrogen produced by electrolysis?

Yes but within the NIC/ strategic Innovation Funds, not from core price control allowances. Hydrogen produced via electrolysis and using renewable electricity (i.e. green hydrogen) is a key component of our pathway to net zero by 2050. Additionally, we have outlined various hydrogen projects that we intend to deliver in RIIO-2, in Appendix A14. We are also heavily involved in delivering HyDeploy 1 and HyDeploy 2, which involves production of hydrogen through electrolysis and blending of hydrogen into gas networks. As part of the HyDeploy 2 project, during 2020, NGN will have up to 600 properties being served with a gas supply including up to a 20% blend of hydrogen. The first public network in the UK to be supplied in this way.



Part 5.1 – Enabling whole systems energy solutions
Appendix A14 – NGN RIIO-2 Our Whole Systems Strategy

10. Costs

RIIO-2 Challenge Group Assessment
of V2 Business Plan

Amber/ Red

The challenge

The totex has not changed from July. Sensitivities are provided highlighting the implications and risks of expenditure deferments or cancellations. The plan proposes ongoing efficiencies to keep NGN at the frontier of efficiencies during RIIO-2, including building on efficiencies in direct labour, investment procurement, maintenance outsourcing (which we note has now been reversed), and IT enhancements. However, as set out above, proposed year on year efficiency gains are only targeted at 0.5% which appears unambitious.


Repex – please provide a clear profile for your chosen mandatory and non-mandatory volumes, and associated unit costs, setting out the key changes and reasons for change over RIIO-1 and 2, including the efficiency gains you have realised and planned.

NGN Assessment
(based on response to feedback)

Green

Our response

Part 2 of our plan outlines the various ambitious programme of investment and business change we have undergone during RIIO-1 which has driven our frontier position in the sector and prepared us for RIIO-2. This sets the context for our proposals for RIIO-2, where our efficiency targets still exceed those estimated by the Bank of England over the next 3 years and generate savings of nearly £20m over RIIO-2, whilst delivering an ambitious and higher level of service across the board. Using Ofgem’s toolkit for assessing relative efficiency, NGN’s performance is at the frontier of efficiency in the UK. But also shows that at a Totex level, NGN are 6% ahead of the next GDN and close to 20% ahead of the least efficient. Future efficiencies must be viewed in this context.

 *Part 2 – Giving customers confidence that we will deliver*
Part 6 – Delivering value for money

Part 6.5 of our plan – supported by the Business Plan Data Tables and our Investment Decision Pack appendices on Mandatory and Non-mandatory Repex – provides details of our proposed investment profiles. These include information on workload volumes and associated costs, changes between RIIO-1 and RIO-2 and efficiency gains delivered and planned. Waterfall traces are included for all areas. An example of the interaction between unit rates, workloads, and overall programme costs for RIIO-2 has been included at the beginning of part 6.5, covering Tier 1 and >2” Steel Mains.

Part 6.5 – Replacement expenditure summary
Appendix A23M – NGN RIIO-2 Investment Decision Pack Mandatory Repex
 *Appendix A23N – NGN RIIO-2 Investment Decision Pack Non-mandatory Repex*
BPD 5.0-5.11

11. Engineering Justifications and CBAs

RIIO-2 Challenge Group Assessment
of V2 Business Plan

Amber/ Red

The challenge


More information has been provided since the July plan - the number of engineering justifications has doubled. Weak evidence has been provided to support expenditure plans, especially your approach to probability of failure, iron mains replacement, and explanation of unit costs. Further evidence should be provided to ensure full justifications are available in your December plan.

NGN Assessment
(based on response to feedback)

Green

Our response

All our Investment Decision Packs are complete. Further evidence has been provided in the areas highlighted. Throughout the process we have played an active role in developing the Cost Benefit Analysis and Engineering Justification templates and have completed these in accordance and with agreement from Ofgem.

 *Appendix A23 - NGN RIIO-2 Investment Decision Packs*
NGN RIIO-2 Cost Benefit Analysis

12. Finance

RIIO-2 Challenge Group Assessment of V2 Business Plan

Amber/ Red

The challenge

Working assumptions (WAs) – Both the Notional and Actual Companies have been modelled using Ofgem’s WAs and a full suite of the sensitivities required by Ofgem presented and, to some extent, analysed. The noncompliant ‘Base Case’ has been clearly distinguished from the Ofgem required cases. It is important to be clear in all submissions what models or tools your quantitative output is based on. It is acceptable at this stage (though not in December) to use only your own internal financial models but important that in December the main plan and financeability analysis refers to outputs from the Ofgem business plan financial model. We also expect transparency (e.g. clear cross-referencing to supporting files) and submission of any model or tool used for any supplementary analysis included in the business plan, including bill impact estimations.

NGN Assessment (based on response to feedback)

Green

Our response

The key quantitative financial outputs in the final business plan have been derived using Ofgem’s LiMo ver. 4.1. The financeability analysis also refers to the LiMo.

However, the LiMo does not contain functionality to calculate Customer bills and credit ratings, implied by the relevant credit metrics. Therefore, these two elements of the business plan have been calculated in other models, which have been submitted alongside the business plan.



Part 7.2 – Assessment of Ofgem’s ‘base case’

Part 7.3 – Options to address financeability

Part 7.5 – Customer bills

Financeability – Your plan appears to be financeable on both a notional and an actual basis at 4.8% equity return without further mitigating actions. Financeability of the Actual Company is tight but produces projected Moody’s ratings which are at or above the minimum for investment grade in all of the Ofgem sensitivity tests. Despite this, you focus on a ‘Base Case’ with a 5.0% cost of equity allowance with no 0.5% RORE incentives outperformance assumed in the base case and a 3.5% (versus Ofgem’s 3%) dividend payout.

The notional company appears financeable mainly because of Ofgem’s assumptions on gearing and the cost of debt, both of which are considerably lower than the actual average position in the gas distribution sector.

Actual company under Ofgem’s working assumptions does not achieve NGN’s target credit rating of Baa1/BBB+, which, according to the independent research, represents a better value for customers than lower ratings within the investment grade.

In accordance with Ofgem’s requirements, we have moved our proposed Financial Package for RIIO-2 in a separate document – Appendix 33.

NGN’s proposals on the cost of equity and on the cost of Debt are not a function of the financeability assessment. They represent, in our view, an appropriate balance of risk and reward between customers and investors and are based on the comprehensive theoretical and empirical evidence.

We also recognise the role equity should play in addressing financeability concerns. Therefore, we have assumed a reduction in the dividend payout ratio of 1.5% from the suggested headline equity return, which is commensurate with long-term UK GDP forecast growth rate.

Part 7.1.3 - Financeability

Part 7.2.2 –Financeability Assessment

Part 7.3 – Options to address Financeability

Appendix 33 – Proposed Financial Package for RIIO-2.



Financeability – We are also not clear why you consider a cost of debt higher than Ofgem's WA or an additional 68bps debt issuance costs are needed when your current projected actual cost of debt is around 1% below Ofgem's WA at the beginning of RIIO2.

One of Ofgem's principles for setting the cost of debt allowance states that 'the cost of debt allowance should be a fair and reasonable estimate of the actual cost of debt likely to be incurred by a notionally geared, efficient company'. Therefore, we have based our analysis on a notional efficient company's debt costs. The latter are represented by the sector average cost of debt, which, as independently estimated by NERA, is expected to be significantly higher than Ofgem's working assumptions.

Due to our prudent financing policy and efficient hedging strategy, NGN has been the frontier company in the sector, including a performance on the cost of debt. However, it would have been inappropriate to calibrate a cost of debt allowance for the gas distribution sector on the frontier performer.


Furthermore, our proposal of 14-18-year trombone average of iBoxx index for the cost of debt allowance is relatively insensitive to the assumed value of the additional costs of borrowing. Under the scenario when 68 bps of additional costs is assumed (as independently assessed to be appropriate for GDNs in RIIO-2 by NERA), the gas distribution sector would still underperform an allowance by 37-55 bps using the proposed 14-18-year trombone. If Ofgem's RIIO-1 assumption on the additional costs of borrowing (20 bps) were to stay unchanged for RIIO-2, the sector's performance would range from -8 to 10 bps depending on whether it is measured using debt-weighted or equality-weighted averaging methodology.

 **Appendix 33. – NGN's Proposed Financial Package for RIIO-2.**

Financeability – You have rejected changes to both depreciation and capitalisation rates as routes to improving financeability but have not sufficiently explained why these measures, which were accepted in RIIO1, would not be feasible in RIIO2.

The "speed of money" adjustments adopted in the current price control (e.g. capitalisation rates) have been discounted by the rating agencies and there is evidence that this will continue to be the case in RIIO-2. We have also considered the reduction in asset lives and concluded that it would not support financeability in terms of one of its key metrics – AICR.


The full set of reasons for rejecting these measures has been outlined in the relevant section of the business plan.

 **Part 7.3. – Options to address financeability**

Financeability – You appear to have considered a shortening of the depreciation period only as a potential aid to financeability and not in the wider context of the future of the gas sector and the potential for asset stranding. Greater clarity in relation to your intentions in relation to new equity in the Actual Company would be helpful.

We recognise the risks associated with an uncertain future of gas in the UK energy mix. However, we considered it inappropriate to shift all associated risks onto present customers through, for example, shortening the asset lives.

We have provided additional detail on the implications of additional equity injection and clarified our intentions in relation to new equity for the actual company.


 **Part 7.3. – Options to address financeability**

Consumer engagement – It is clear from the reference to your 'Citizens' Jury' that an attempt has been made to involve consumers in issues relating to financeability but there is no evidence of detailed engagement in relation to specific financing issues and the trade-offs that those imply. We can see the reason for having headroom in target ratios over the minimum required to maintain an investment grade rating (BBB-) but we have not seen sufficient evidence that a BBB+ target is better value for consumers than BBB- or even a BBB target. There has been improvement in a number of areas which we raised in our feedback on your July plan: e.g. you are showing financeability on an actual basis and full sensitivity analysis but the requested sensitivity based on a 4.3% equity return has not been shown and we consider you could have explored consumer value further by doing additional analysis on what level of notional gearing is optimal for consumer value, balancing WACC and financeability considerations. We note that, despite our request for a full plan in October, you are reserving your position on cost of capital allowances until December.

A comprehensive independent analysis has been carried out on the relative costs and benefits of targeting a lower credit rating than BBB+/Baa1.

A separate stress-test under the zero RoRe outperformance scenario (4.3% equity return) has been carried out and presented in the relevant section of the business plan.

We have considered a further reduction of notional gearing below 60% and concluded that it would not be appropriate from both customer's and investor's perspective.

 **Appendix A26 - NGN RIIO-2 Assessment of a Comfortable Investment Grade Credit Rating**
Part 7.2.2 -Financeability Assessment
Part 7.3. – Options to address financeability

13. Customer Value Proposition (CVP)

The challenge

Your CVP is a work in progress. You have summarised the outputs which you believe deliver additional value and the processes, including further engagement with your CEG and factoring in of outputs of customer valuation and engagement, which you will be undertaking as you seek to refine and quantify. We note that the Ofgem minimum requirements in relation to meeting needs of customers, including those in vulnerable circumstances and addressing the environmental impact of the network and your contribution to low carbon transition, set a high bar. We consider that you have identified a number of deliverables, particularly in supporting customers in vulnerable situations, which may potentially provide additional value. These include your Hardship and Community Partnering Fund proposals and your stretch target for fuel poor connections. As previously noted, the justification for these proposals and other bespoke outputs, including choice of particular measures and quantification of benefits and value for money, needs to be clear and the impact on different groups of consumers should be considered. As noted in Ofgem's guidance, the issue of delivery/ consequences of non-delivery should also be considered.

Our response

We have completed our analysis of our CVP and have included in our analysis benefits by beneficiary type. Our CVP delivers the highest value to vulnerable customers over the RIIO-2 period. The detailed methodology that we have applied is detailed in Appendix A 13. A summary of our approach is also detailed in Part 4.5 of our business plan.



Part 4.5 – Our Customer Value Proposition

A13 – NGN RIIO-2 Customer Value Proposition