Citizens Advice response to Ofgem's Natural Gas asset repurposing valuation methodology consultation

Introduction

Citizens Advice is pleased to respond to Ofgem's consultation on the valuation methodology for repurposing natural gas assets. As the UK moves towards net zero, it is vital that the transition costs are shared equitably across society. An important part of this is how to fairly distribute the costs of repurposing and decommissioning gas assets.

We believe the valuation methodology for repurposing gas assets must strike a fair balance between gas and hydrogen consumers. Gas consumers have paid for gas assets and are entitled to full compensation if assets are repurposed. At the same time, it is important that hydrogen consumers do not re-pay for assets that have already been funded, and that the price paid for repurposed assets reflects the utility of the asset they inherit. Attention also needs to be given to how this consultation interacts with wider decisions around how decommissioning costs should be distributed.

Questions

Q1. Do you agree with our minded-to methodology for the valuation of repurposed natural gas assets, Depreciated Replacement Cost?

Citizens Advise agrees with Ofgem's minded-to Depreciated Replacement Cost (DRC) methodology for the valuation of natural gas assets. This approach allows the transfer value to capture the remaining economic value of the asset, which should avoid under or over valuing the asset. Gas consumers will receive value for repurposed assets that still have useful life, and hydrogen consumers will pay a fair price. This should lead to a fair balance for gas and hydrogen consumers.

The Net Book Value approach would require identifying the original asset costs, historical capex spend and historical accumulation which would be challenging.

Since gas assets would likely be fully depreciated from an accounting perspective at the time of transfer, using the Net Book Value approach would likely result in the transfer value being too low, as it does not reflect the remaining useful life of the asset.

We take the depreciation term of the DRC formula to be valuation depreciation following RICS guidance, not accumulated historical depreciation following an accounting depreciation approach, and would find it helpful to have this clarified in the methodology. We believe that it should be a requirement (rather than an expectation) that the parties commission a suitably independent party to calculate both the MEAV and valuation depreciation in line with the RICS guidance, to ensure that the valuation is fair and accurate.

It is reasonable to assume that by the time gas assets are transferred, the assets would have been fully or mostly depreciated. Since gas consumers have paid for gas assets, the transfer value must be returned to consumers. Ofgem should provide confirmation on how the value will be distributed back to gas consumers. Where there are still customers on the gas network, this is best achieved through a lump sum given to gas consumers instead of a reduction in the RAV so that consumers see their return immediately, ahead of the consumer base dwindling. In a scenario where there are minimal or no gas consumers left at the point of transfer, consideration should be given on how to compensate consumers.

Ofgem should also consider how a potential scenario where the transfer value is greater than the remaining RAV on the gas side should be dealt with.

Q2. Do you agree with the inclusion of a bespoke adjustment mechanism to account for any repurposing costs incurred by the gas network before transfer of the assets to make these assets suitable for transfer to a hydrogen network?

We do not support the inclusion of a bespoke adjustment mechanism to account for repurposing costs incurred by the gas network prior to the transfer. If an adjustment mechanism was applied to the transfer value to cover the repurposing costs prior to the transfer, this would mean the costs are passed over to the Hydrogen side. Repurposing costs prior to the transfer should sit with the gas side, but be treated as equivalent to decommissioning costs. The Government needs to take action and give some certainty on how decommissioning costs will be distributed. It is not fair for gas consumers to

bear decommissioning costs alone. These costs need to be socialised across society, whether through taxation or shared with investors.

We would expect some repurposing costs to be captured within "functional obsolescence" in the DRC depreciation term, whereas they would not be if the Net Book Value approach were used. This should be considered to ensure repurposing costs are not double-counted.

Q3. Do you agree with the inclusion of a bespoke adjustment mechanism to account any repurposing costs incurred by the hydrogen network after transfer of the asset to make the assets useable in a hydrogen network?

We do not support the inclusion of a bespoke adjustment mechanism to account for repurposing costs incurred by the hydrogen network after the transfer of the asset. If the transfer value was adjusted to reflect these costs, then gas consumers would be paying for the costs. Repurposing costs incurred after transfer should sit with the hydrogen side.

Q4. Which set of consumers, the transferring party or the receiving party, should cost incurred before the transfer of assets that are necessary to make the asset useable in the new network, sit with?

We believe that repurposing costs incurred before the transfer of assets should sit with the gas side, but these costs should be treated as decommissioning costs which should be socialised.

Q5. Which set of consumers, the transferring party or the receiving party, should cost incurred after the transfer of assets that are necessary to make the asset useable in the new network, sit with?

We believe repurposing costs which are incurred after the transfer of assets should sit with the hydrogen side, since they would be paying for all relevant costs if the asset was built new and they benefit from the transferred asset. These costs should be treated as any other hydrogen expenditure, sitting within total expenditure (TOTEX).

Q6. How should decommissioning liability associated with assets that have been repurposed be distributed? What is the most suitable mechanism to facilitate the distribution of decommissioning liability?

We do not have a view at this point on how decommissioning costs relating to the end of life of a hydrogen asset should be distributed.

Decommissioning costs that are required due to the net zero transition or other government policy should not sit with either the gas or hydrogen party alone.

These costs should be socialised across society, for instance, using government intervention funded through taxation, or shared with investors.