

Kiran Turner,
Network Price Controls,
Ofgem,
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London,
E14 4PU

31st August 2018

Dear Kiran

PSUP reopener Ofgem consultation

This letter provides National Grid Electricity Transmission's (NGET's) formal response to Ofgem's consultation letter dated 8th August 2018 relating to costs associated with the May 2018 re-opener for enhanced physical site security upgrade programme (PSUP). This main body of this response is not confidential. The appendix supplied as separately is strictly confidential and is not for publication.

Ofgem have assessed NGET's request to adjust allowances by -£64.7m and as a result have proposed that allowances be adjusted by -£68.4m. This proposed adjustment mainly places emphasis on reducing the project management and risk costs included within NGET's request. In summary, the proposed adjustments do not fully take account of all the relevant circumstances or align with the numerous cost reviews that have been undertaken by various parties. The outcome of the approach is also inconsistent with the outcome of the 2015 determination. The areas in which we are asking Ofgem to re-consider their conclusions and the supporting rationale are included within our consultation response attached to this letter.

We are happy to discuss any element of this response directly with Ofgem at a time of your convenience.

Yours sincerely,

Mark Brackley

Project Director, UK Regulation, National Grid

NGET Response to Ofgem's consultation on proposed allowance adjustment for enhanced physical security upgrade programme (PSUP)

This document provides a response to the two questions outlined within Ofgem's consultation;

1. Do you agree with our assessment approach?

In summary, we agree that Ofgem's assessment approach as outlined within their consultation seems appropriate in most areas given the nature of the request being both a reduction of existing allowances and request for new allowances. We do however disagree that Ofgem's approach to determining appropriate project management costs and risk value is acceptable considering the differences between PSUP projects and standard civils projects. We have provided reasoning for this view within our response to question 2.

2. Do you agree with the outcome of our assessment?

Whilst we agree Ofgem's assessment approach is broadly a sensible one, not enough recognition has been given to the specific circumstance and requirements of the new works and the supporting evidence provided within NGET's submission request, or have provided robust evidence to support the initial conclusion. We would ask Ofgem to reconsider their conclusions in the following areas;

- Project management
- Risk
- Costs relating to specific works

Comparison with 2015 adjusted allowances

If a benchmarking approach were taken to make an adjustment to requested allowances, a different approach from the one used by Ofgem could be taken. The analysis in the appendix compares the total costs of the scheme divided by the fence length to give a £/metre average cost, and benchmarked new PSUP outputs against this. When comparing our forecast costs for the PSUP solutions requested in this submission, they are not significantly above the adjusted allowances for similar sites that were "to be constructed" in the 2015 submission. This is shown in the chart in the appendix and is confidential due to commercially sensitive information.

From looking at the significant differences of the new sites' outputs, we suggest a simple benchmarking approach is not entirely robust. Instead, outputs need to be assessed individually, taking into consideration their complexity, maturity of development, level of risk, and delivery timescales. We have provided justification as to why we think Ofgem should reconsider their views in these areas below.

Project management

Within the consultation, Ofgem state 'As part of this reopener we have received a view from Frazer Nash Consulting (FNC) that the total PM costs (including any contractors) for civils projects would typically be between 5% and 15%' following assessment and comparison. Taking account of this and other views Ofgem propose to reduce total Project Management costs to 15% of the total project cost.

We respect the expertise and experience of Ofgem's consultants in providing this view, however the detail supporting this view has not been published and therefore we cannot consider the type of project and calculations made which led to this conclusion.

Ofgem have outlined comparisons made within their consultation which we believe do not account for the added complexity of transmission PSUP schemes and the interaction with transmission deliverables for which the project management costs included within NGET's request are associated.

PSUP projects are also geographically dispersed which provides project management challenges compared to a single site. Whilst we have implemented and continued to explore productive ways of working to manage this, the dispersion has a significant impact on the project management resource required to manage the programme.

The values in the comparison are based on a single overhead transmission line project do not lend themselves to a like for like comparison with PSUP. The costs involved in these projects are heavily geared towards materials procurement (65% of total cost as per confidential Parsons Brinkerhoff study used by Ofgem) and as such, the Project Management costs will reflect a lower total percentage of costs. By comparison, a PSUP project is less focused on materials procurement (22% of total cost), with a greater focus on the resource required for installation and management of the works; these manifest as a higher percentage of project management costs. In summary, a percentage comparison cannot be used to compare these projects.

Our contracting strategy was devised to be best for task, bearing in mind considerations such as the magnitude of the programme of works, risks associated with interfacing two contractors and the complexity of the works. Whereas a different contracting approach, as adopted by other Network Operators with smaller projects, cannot be directly compared to the delivery model adopted by NGET and any comparison also needs to take this consideration into account.

In summary, the comparisons made are not like for like and do not take into consideration individual aspects of a PSUP project. We therefore do not consider this an acceptable approach to determining appropriate project management costs and ask Ofgem to re-consider their conclusions by considering the points outlined above.

Risk

Within the consultation, Ofgem state *'We do not consider the current cost estimate under NG's risk model to be efficient and we are proposing to reduce the risk costs to 10% of the total costs'*.

Whilst NGET agrees that 10% might be an appropriate value for risks on a simple civils project, or at a later stage of project development, we do not regard the PSUP project a simple civils project, or at a stage of development where the risk value is naturally lower.

NGET maintains that the risk allocation of 15% of total scheme costs is appropriate considering the information available of how costs have changed on other sites in the portfolio. We contend that risks

need to be assessed on a project specific basis. Some averaging may be reasonable when benchmarked across a wide portfolio of similar projects, however the comparisons made use dissimilar projects, with different challenges and risks.

We also consider it inappropriate to compare risk allocations between different licensees submitting requests within the May 2018 re-opener window. The projects for which allowances are being requested are at different stages of project development and the complexities related to these projects are very different.

All the schemes included within NGET's request are currently in the early planning stages. Therefore, it is reasonable to have a higher risk percentage when compared to estimates based on later stage detailed designs. Independent research has been completed by numerous sources and it is widely acknowledged that at the current stage of development for the PSUP, feasibility estimate cost certainty would fall within a range of between -25% and +75%. This window in 2018 is the only opportunity remaining during T1 to make changes to allowed expenditure and so the estimates are based on the information that we had available at the time of the reopener.

It is unclear from Ofgem's line by line analysis of our risk registers which specific risks they are disallowing to arrive at the overall 9% total. NGET is applying mitigating action to the risks at every opportunity to reduce overall cost, to which both NGET and end consumers would be exposed. Where Ofgem have suggested that risks can be removed through mitigation, it is not clear how this cost of mitigation has been reflected in the base works estimate.

In summary, we consider it inappropriate to compare projects at different stages of development to determine an acceptable risk value. We ask that Ofgem reconsider their views on risk and reinstate removed risks.

Costs relating to specific works

Cabling and communications

These costs were estimated based on historic costs incurred. This calculation results in a unit cost and volume based on the experience of the complete portfolio. In this case, the contractor made a mistake in their assumptions. It was agreed with them that an overlay should be added to the price. The additional volume of cable is required to deliver the output and the c£0.5m allocated is an accurate reflection of the cost required to deliver the output. The under-scoping by the contractor would not have delivered the output.

Minor costs

The works undertaken in this category are not a duplication of existing telecommunications infrastructure. Therefore, these costs are clearly attributable to PSUP and would not be required if the site were not CNI. These are for the sole purpose of PSUP and have cyber security controls applied to ensure it is a PSUP dedicated connection. Therefore, these costs are incremental, efficient and directly attributable to PSUP, as such they should be included within the allowed expenditure.

General items & preliminaries (GIP)

Ofgem is minded to reduce allowed expenditure, partly due to the lack of a VFM audit and partly due to a perceived lack of evidence that the sites that require funding have unique circumstances. The circumstances that are unique to NGET is the duration of the project for which these general items are allocated. As it is longer, the percentage of the overall costs will also be increased.

The confidential Harnser report used in 2015 by Ofgem and referenced in the consultation recognises that the perimeter length impacts the cost implications of a PSUP project. As National Grid sites are on average larger than other Network Operator sites it is expected there would be higher costs incurred. This factor has not been considered in the reference values.

The 2018 submission is based on current market conditions, for instance the increase in steel prices has offset other savings made in procurement. Therefore, a straight read across from the 2015 assessment approach is not entirely appropriate. NGET has developed its delivery model since 2015 to deliver savings, these have already been included in proposed costs and so it is not appropriate to apply the same reductions.

The costs included within NGET's submission reflect an accurate representation of the cost to manage, set up and secure a CNI transmission site. We would therefore ask Ofgem to reconsider allowing these requested allowances for the reasons stated above.

Conclusion

NGET have implemented efficiencies to deliver the PSUP during RIIO-T1 within allowances. These efficiencies have been included within the request for additional allowances to deliver further outputs during RIIO-T1 and this is reflected within the submission. NGET agrees with the adjustments proposed in the return of allowances to £74.0m. We do not however agree that the comparisons made to determine appropriate project management and risk costs are acceptable for these reasons outlined within this response. The requested allowances are required to deliver the outputs agreed with Government and CPNI and are based on specific estimates which are appropriate for the stage of development for these schemes. With this in mind, we ask Ofgem to re-consider NGET's request for the proposed adjustments outlined within Ofgem's consultation.