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Dear colleagues,

RIIO-GD1: Our decision on Cadent Gas Limited's application under the Specified Street Works Costs reopener

This letter sets out our¹ final decision on Cadent Gas Limited's (Cadent) price control reopener application, made under Special Condition 3F (Arrangements for the recovery of uncertain costs) of its Gas Transporter licence, for an additional allowance of £21.3m² to cover Specified Street Works Costs in the East of England area.

On 8 August 2018, we published a consultation on our assessment of Cadent's application and sought the views of interested parties.³ We received one non-confidential response from Cadent, which has been published alongside our consultation.

Our final decision

Having considered Cadent's response and taking account of our principal objective and statutory duties, and in accordance with Special Condition 3F of Cadent's licence, we have decided to provide additional allowances of £17.3m for the East of England area.

The requested and allowed amounts are shown in Table 1.

¹ The terms 'Ofgem', 'the Authority' 'we', 'us' and 'our' 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 and allowances in this document are reported in the 2009/2010 price base, unless otherwise stated. All costs presented have been rounded which may appear as rounding errors. The final allowance profile should be taken from the allowance profile in the next steps section.

³

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

Table 1: The requested and allowed funding for Cadent’s Specified Street Works Costs during the RIIO-GD1 period (2009/2010 price base).

	Requested Funding for RIIO-GD1	Allowed Funding for RIIO-GD1	Difference	Percentage difference
Permit Fees	£5.0m	£4.9m	£0.2m ⁴	3.1%
Administration Costs	£7.3m	£5.3m	£2.0m	26.9%
Productivity cost impact	£9.0m	£7.2m	£1.8m	20.2%
Total	£21.3m	£17.3m	£3.9m	18.5%

The remainder of this letter sets out the background to Cadent’s application and the reasons for our decision.

Background

The current price control for gas distribution network companies includes a reopener mechanism for licensees to apply to the Authority for an adjustment to their expenditure allowances for Specified Street Works Costs. These are certain costs that have been incurred, or are expected to be incurred, by the licensee in complying with obligations or regulations made pursuant to Part 3 of the Traffic Management Act 2004 (or, in Scotland the Transport (Scotland) Act 2005), that impose a permit scheme, or under any wider street works legislation applicable to the licensee.

At the time of setting allowances for RIIO-GD1, there was uncertainty around street work costs where Highway Authorities (HA) had not introduced permit schemes prior to the start of RIIO-GD1, but were expected to do so during the price control period. We therefore put in place an uncertainty mechanism in Special Condition 3F of the gas transporter licence held by the Gas Distribution Networks (GDNs). The mechanism allowed GDNs to apply to the Authority to adjust their expenditure allowances to cover additional efficient Specified Street Works Costs, where the amount exceeds or is likely to exceed a materiality threshold.

The licence provides two reopener windows for applications to be submitted, May 2015 and May 2018. In May 2015, Cadent (previously National Grid Gas Distribution) submitted an application for additional allowances for Specified Street Works Costs relating to its East of England network area. Following our assessment, we did not direct an adjustment to Cadent’s allowances because our view of efficient costs fell below the materiality threshold set out in the licence.

We received another application from Cadent as part of the May 2018 reopener for additional allowances for Specified Street Works Costs for the East of England area.

Cadent’s application covers three categories of Specified Street Works Costs:

- **Permit fees** – These are costs associated with obtaining permits for undertaking street works in HA areas covered by a permit scheme.
- **Administration costs** – These are costs relating to administration and management work required to support street works undertaken in areas covered by a permit scheme.
- **Productivity cost impact** – These are costs incurred as a result of the impact of permit conditions imposed on street works (undertaken in areas covered by a permit scheme).

Our assessment of Cadent’s application was in two phases. Phase one was an informal

⁴ This is a rounding error.

consultation on its submission, from 17 May to 20 June 2018.⁵ We received no responses. Phase two was a consultation, presenting our initial view, from 8 August to 29 August 2018. We received one response, from Cadent.

In our consultation, we welcomed the initiatives Cadent has introduced, such as using internal training courses and lessons learned sessions to draw on experiences of colleagues to increase administrative knowledge and understanding of requirements for permit schemes between different HAs, which represent a good outcome for consumers. We also appreciate the work that Cadent has done to work with stakeholders and HAs to mitigate the impact of street works on road users, thereby reducing costs for consumers.

We have now reached our final decision. Following our review of Cadent's response, we maintain our initial view that:

- Cadent's actual reported expenditure to date in the three categories of Specified Street Works Costs appears reasonable.
- Cadent's approach for forecasting permit fees appears reasonable, but we do not accept Cadent's method for forecasting administration and productivity cost impact. We consider that the methodology used for forecasting permit fees should also be applied to forecast administration and productivity cost impact. Applying the same methodology to all three categories of costs reduces the forecast costs in those categories by £3.9m.

The reasons for our decision and a summary of the consultation response received are set out below.

Reasons for our decision

Permit fees

Cadent requested additional allowances of £5.0m to cover costs associated with permit fees. This was to cover actual costs incurred in the first four years of the RIIO-GD1 price control, £1.8m, as well as forecast costs for the remaining four years, £3.2m. In our consultation, we set out our initial view, which was to provide an allowance of £4.9m to cover the whole RIIO-GD1 period.

In its response, Cadent did not comment on our initial view on permit fees, other than to note the approach we had taken.

We have decided not to make changes to our consultation position. Therefore, for the reasons set out in our consultation, our final decision is to allow £4.9 for permit fees over RIIO-GD1, which is lower than the requested amount by Cadent by £0.2m.

Administration costs

Cadent requested an allowance of £7.3m to cover administration costs relating to permit schemes. This was to cover actual costs incurred in the first four years of the RIIO-GD1 price control, £2.6m, as well as forecast costs for the remaining four years, £4.62m. In our consultation, we set out our initial view, which was to allow £5.3m of additional funding, £2.0m less than Cadent's request.

For the costs incurred to date, following our assessment of the eight subcategories of administration costs: back office administration, management costs, training costs, IT costs, traffic management schemes, traffic management plans, pre-site surveys and site meetings, we considered that these incurred costs appear broadly reasonable and our initial view was to allow them.

⁵ [Informal consultation on RIIO-1 price control reopeners \(May 2018\)](#)

In respect of forecast costs, Cadent had used a different methodology for forecasting administration and productivity cost impact to the one it used to forecast permit volumes. This produced different forecasts for permit volumes compared to the methodology used to forecast permit fees. As Cadent used an acceptable methodology to forecast its permit costs, our initial view was to apply that same methodology to both the administration and productivity cost impact forecasts.

Cadent's response to the consultation stated that "*we believe our approach is a more accurate methodology than that used by Ofgem for assessing forecast costs for the remainder of RIIO GD1.*" We disagree that the methodology Cadent has used to produce forecasts for administration and productivity cost impact is appropriate. It assumes that the administration workload for each HA is equal, which we consider is demonstrably not the case and likely to have resulted in an inaccurate forecast. For instance, Hertfordshire issued 12,950 permits between 2013/14 and 2016/17, whereas Surrey issued 37 permits in the same period. We therefore maintain our view that the approach we used to forecast administration costs and productivity cost impact is more robust and consistent.

We received no other feedback on this cost category. In conclusion, we have decided not to make changes to our consultation position, which is to allow a total of £5.3m for administration costs over RIIO-GD1, which is a reduction of £2.0m compared to Cadent's requested £7.3m.

Productivity cost impact

Cadent requested £9.0m of funding to cover the productivity cost impact of street works permit schemes. This covers actual costs incurred in the first four years of the RIIO-GD1 price control, £4.0m, as well as forecast costs for the remaining four years, £5.0m. In our consultation, our initial view was to allow £7.2m of funding.

Based on our assessment, we consider that the costs incurred to date appear broadly reasonable and our decision is to allow them. However, we set out our concerns about the methodology used by Cadent to forecast productivity cost impact over the remaining four years of the price control. Our initial view was to apply the same forecasts of permit volumes that we used for permit fees and administration costs. This is for the same reasons discussed in the administration costs section above. We also forecast the productivity cost impact using permit volumes and length of mains decommissioned under the replacement expenditure (Repex) programme.

In its response to our consultation, Cadent disagreed with our methodology for forecasting permit volumes, and said that its own methodology better reflected the increased workload in replacement work. We disagree. Our methodology takes account of mains replacement (Repex) workload and we believe that our approach provides greater consistency and robustness of forecasts across the three cost categories in Cadent's submission.

Therefore, for the reasons set out above, our decision is the same as our initial view, which is to allow a total of £7.2m for productivity cost impact over RIIO-GD1, which is a reduction of £1.8m compared to Cadent's requested £9.0m.

Next steps

Our final decision on Cadent's allowances for Specified Street Works Costs for the East of England area is set out in Table 2 below.

Table 2: Requested and final allowance profile for Cadent’s Street Works Costs.

(09/10 Prices) £m	13/14	14/15	15/16	16/17	17/18	18/19	19/20	20/21	Total
Requested Allowance	0.58	1.79	3.45	2.65	2.89	3.11	3.27	3.52	21.26
Initial view	0.58	1.77	3.39	2.57	2.16	2.33	2.31	2.21	17.34
Final Decision	0.58	1.77	3.39	2.57	2.16	2.33	2.31	2.21	17.34

Our decision will be implemented through the 2018 Annual Iteration Process, which means that these adjustments to Cadent’s allowed revenues will take effect from 2019/20.

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

Yours faithfully,

Geoffrey Randall
Deputy Director, Gas Network Price Controls