national grid

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Dear Graeme,

Consultation response from National Grid Electricity Transmission on the following Medium Sized Investment Project; Melksham Operational Tripping Scheme (OTS) Phase 2, Frodsham Customer Connection and Lister Drive Customer Connection & Cellarhead Customer Connection

Thank you for the opportunity to respond to the above consultations which we do so on behalf of National Grid Electricity Transmission (NGET). This letter provides the summary of our response, and the full detail is included in Appendix 1, by way of answer to each question posed in the consultation.

We do not agree with the proposed costs that Ofgem has set out in the cost assessment section. We have laid out below the area where Ofgem are minded-to reduce the funding and provided additional information as to why we do not agree with the treatment of the costs.

Contractor activity

The proposal to remove elements of contractor activity from our funding request and categorise them as Closely Associated Indirect (CAI) costs is an error and is fundamentally at odds with the CAI and Opex Escalator framework designed for RIIO-2. For all the investments in the RIIO-2, contractor costs are Direct costs. This is supported within both the RIIO-T1 and T2 RIGs under the Direct Activities definition Ofgem note that "where contractors have recharged the licensee for the primary purpose of performing direct activities which include costs for indirect activities, but these are not explicitly costed in their invoice, all costs will be treated as direct". All the contractor costs are onsite work relating directly to assets on the transmission system, dedicated for the period of delivery and cannot be classed as indirect or support roles. Therefore, all contractor costs in these submissions must be treated as Direct costs in accordance with the RIGs definition. Further details on this item are listed against question 4. This response is consistent with the Extreme Weather consultation response sent on 16th June 2022.

Yours sincerely,

[By email]

Patrick Hynes

New Infrastructure Regulation Manager, National Grid

Appendix 1

> **Consultation Question 1: Do you agree with our 'minded to' view on the validity of the needs case for the MSIP Projects?**

Yes, we agree with Ofgem's minded-to view on the validity of the needs case for Melksham Operational Tripping Scheme (OTS) Phase 2, Frodsham Customer Connection and Lister Drive Customer Connection & Cellarhead Customer Connection.

> **Consultation Question 2: Do you agree with our technical assessment of the range of solutions to meet the needs case?**

Yes, we agree with Ofgem's technical assessment of the range of solutions to meet the needs case for Melksham Operational Tripping Scheme (OTS) Phase 2, Frodsham Customer Connection and Lister Drive Customer Connection & Cellarhead Customer Connection.

> **Consultation Question 3: Do you agree with our minded-to view of the solution proposed by NGET?**

Yes, we agree with Ofgem's minded-to view of the solution proposed by NGET for Melksham Operational Tripping Scheme (OTS) Phase 2, Frodsham Customer Connection and Lister Drive Customer Connection & Cellarhead Customer Connection

> **Consultation Question 4:** Do you agree with our cost assessment of NGET's proposed projects?

We do not agree with Ofgem's view of the project cost and set out our detailed response against each of the specific categories below. The calculation in not consistent with the RIGs, consistent with the basis the coefficient was calculated, or the basis of funding requests.

1. Contractors' Cost

Ofgem's Position for Melksham Operational Tripping Scheme (OTS) Phase 2, Frodsham Customer Connection and Lister Drive Customer Connection & Cellarhead Customer Connection

One element which we propose to adjust is the Site Management and Detailed Design subcategories included in Contractor costs.

Our RIIO-T2 reporting guidance instructs the Transmission Owners (TOs) on defining costs of Direct or the Closely Associated Indirect Activities (CAI). In summary, Direct costs are those which include expenditure attributable to physically delivering works on assets on site. Direct costs do not include works which have no physical interaction with the assets. We asked NGET to provide more information on what activities have been included in the above two cost subcategories and why they have been categorized as Direct costs instead of CAI.

Based on our analysis, we consider that NGET has miscategorized the contractor's Site Management and Detailed Design subcategories under Direct costs instead of CAI costs. Accordingly, we propose to remove these cost elements from the Direct funding requested by NGET for the Melksham OTS extension project, Frodsham Customer Connection and Lister Drive Customer Connection & Cellarhead Customer Connection. Instead, NGET will receive an automatic uplift (OPEX escalator) for its CAI activities. This will ensure that NGET does not receive double funding for the contractor's Site Management and Detailed Design activities.

Response

We disagree with your proposed adjustments relating to contractor activities as there is an error in application of the Opex Escalator.

The Opex Escalator was designed to reflect the additional costs incurred by networks through the delivery of additional capital investment triggered by reopeners and uncertainty mechanisms. It is based on the coefficient calculated, using the regression undertaken as part of the RIIO-2 price control assessment. This coefficient was arrived at using data provided by the network operators in line with the RIIO-2 final instructions and guidance published on 20th September 2019[1]. This coefficient was termed the 'opex escalator' and is applied after the reopener funding has been requested. Further details on this can be seen in the table below.

Broadly speaking and as defined by Ofgem, Indirect Activities, which in most cases support work being physically carried out on network assets, that could not on their own, be classed as a direct network or asset-based activity. Indirect Activities generally do not involve physical contact with system assets, whereas direct activities do. For instance, project management, contractor management would sit in indirect costs because it is office based, whereas contractor activity would sit in direct costs as it is based on site with assets. Within the final RIIO-2 guidance, Direct Costs (capex) are defined as including "the labour cost of staff, administration, support staff and safety inspection labour costs". Indirect costs include "Engineering, Management, Clerical Support and the office-based activities of engineering and clerical support staff". These definitions are shown in the RIIO-ET2 BPDT Guidance v1.4 document[1] issued by Ofgem and confirmed as the prevailing agreed definitions at the point of submission of this reopener. In this definitions document where the definition states that the costs are 'Indirect Activity' or expenditure which is not on system assets, this defines Indirects or CAI activities. Appendix 2 also gives an extract of this guidance document. It should also be noted that within both the RIIO-T1 and T2 RIGs under the Direct Activities definition Ofgem note that "where contractors have recharged the licensee for the primary purpose of performing direct activities which include costs for indirect activities, but these are not explicitly costed in their invoice, all costs will be treated as direct".

Our submissions were based on these definitions, to ensure they were consistent with the inputs used in RIIO-2 to calculate the coefficient, and we have only included work directly relating to assets. Within our RIIO-2 submission and determination, site management and supervision were included in the baseline capex allowance and not the baseline CAI allowance (which is the equivalent of the opex escalator category). We are concerned that should we adjust the approach in the manner suggested by this consultation the network operators will be underfunded through a coefficient set on one basis and a cost assessment undertaken on another.

If we were to recategorise the adjusted contractor activity, the CAI value and treatment for of the baseline costs within the RIIO-2 deal would also need modification. The table below illustrates the hypothetical impact of changing the definitions underpinning the coefficient agreed at final determinations and the current interpretation.

The table shows the agreed baseline position for capex and CAI. To arrive at the coefficient, the impact of additional capital investment on CAI is then multiplied by 73.4% to account for the portion of CAI that is deemed fixed, and so does not vary with additional capital investment. A value of £100m has been used to illustrate a potential example of the impact of restating capex as CAI through a change in interpretation of definitions.

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[1] [RIIO-2 final data templates and associated instructions and guidance | Ofgem](#)

		Baseline Capex	Baseline CAI	CAI %ge Capex	Opex Escalator Coefficient
	NGET - baseline	3,606.0	829.7	23.009%	16.889%
	NGET	3,606.0	829.7	23.009%	16.889%
Adjusted FD for reclassification	Site mgt adjustment	-100.0	100.0	-100%	
	NGET adjusted values	3,506.0	929.7	26.517%	19.464%

As the table shows, the resulting coefficient would be increased from 16.9% to 19.5%. Any change in definition or the interpretation of definition of CAI and Direct Capex during the RIIO-2 price control period would necessitate a recalculation of the coefficient to ensure that both consumers and network operators are treated fairly.

Our proposal is to reinstate the funding that has been adjusted for the contractor cost as they are not covered by the scope of opex escalator.

Appendix 2 – List of Indirects as defined in the RIIO-T2 regulatory instructions and guidance:

Glossary

Operational IT and Telecoms	IT equipment which is used exclusively in the real time management of network assets, but which does not form part of those network assets
Project Management	Project Management from authorisation through preparation, construction and energisation to completion. Includes: • Overall responsibility for major project delivery. • Determining resource requirements. • Planning and requisitioning materials & equipment. • Liaising with procurement for non-standard materials as required. • Work and resource programming. • Risk assessments of the overall project content. • Preparation of work instructions. • Issue of work to own staff and contractors. • On-site supervision and technical guidance. • Quality checks on work undertaken. • Organising network access and co-ordination of outages. • Organising and supervising (where appropriate) the undertaking of commission tests. • Issuing completion certificates. • Arranging energisation of assets. • Cost control. Excludes: • Any IT or property costs associated with Project Management. • Any employees managing other indirect activities. • Any design work relating to new connections new or replacement assets

Network Design and Engineering	All processes and tasks involved in the:
	• Strategic planning of the network at all voltages.
	• Detailed engineering design of new connections, extensions and changes to the network at all voltages.
	
	Includes:
	• Strategic planning of the network – Relates to the tasks associated with the network in totality rather than individual projects. Includes:
	    o Maintenance of network design data models.
	    o Development of long term development statements.
	    o Capital planning for business plans and budgets.
	    o Network wide demand forecasting.
	    o Network Modelling associated with determination of Use of System charges.
	    o Strategic planning of the network in respect of new connections, load related network reinforcement and all aspects of the "non-load new and replacement asset installation" activity.

	- General and Fault Level Reinforcement – Relates to the tasks associated with the project specific network design and engineering of General and Fault Level Reinforcement projects. - Demand Connections – Relates to the tasks associated with the project specific network design and engineering of Demand Connections projects and enquiries. - Other Network Investment – Relates to the tasks associated with the project specific network design and engineering of all other aspects of Network Investment projects. The tasks associated with General and Fault Level Reinforcement projects, Demand Connections projects & enquiries & enquiries and all other aspects of Network Investment projects including: - Load forecasting. - Network modelling. - Network and engineering design of the network to accommodate new connections, specific changes in either demand or distributed generation and all aspects of the "non-load new and replacement asset installation" activity. - Provision of connection charge quotations. - Approval of network designs undertaken by other parties, such as independent connection providers and related parties. - The surveying of a specific overhead line in order to identify the detailed work required to address an identified problem/issue. - The determination of land profiles to select the routes and pole sizes for new or replacement lines. - The surveying associated with new and existing operational sites in order to identify detailed work requirements. - Network performance monitoring and evaluation of impact of salient policies. - Planning new projects up to the point of authorisation. Network Design and Engineering excludes: - The surveying, patrolling or inspection of system assets to collect condition information. - Any IT or property costs associated with network design & engineering.
System Mapping	The activity of mapping of the network and operational premises of the network to geographical locations. Includes: - Updating the geographical system maps with asset and locational information following the installation, removal or repositioning of system assets. - The updating of Geographic Systems (GIS) records following Ordnance Survey mapping rebasing upgrades. - Responding to the New Roads and Street Works Act NRSWA notices sent to the Company by other parties. - Ordnance survey licence fees. Excludes: - Clerical support and admin associated with New Roads and Street Works Act (NRSWA). - updating the network control diagram

	• onsite collection of asset and locational information where this task is undertaken with the installation of the asset which is part of the associated direct activity: IT & Property costs associated with System Mapping activity

Engineering Management and Clerical Support	Engineering Management & Clerical Support
	The office-based activities of engineering and clerical support staff (ie depot clerical staff, managers, work planners, etc) managing or assisting employees undertaking direct activities and Wayleave Administration.
	
	Includes:
	• Strategic Network Plan Development and implementation:
	  o Managing the delivery organisational structure to achieve the long and short term company goals.
	  o Agreeing resource requirements (own employees, contractors, finances and outcome targets).
	  o Managing the allocation and distribution of delivery resources to achieve plans.
	  o Managing key corporate policies and standards for investment/ service delivery.
	  o Leading the management team for service delivery.
	  o Monitoring the achievement of plans.
	  o Overseeing the management of teams with responsibility for service delivery.
	
	• Identification and implementation of improvement initiatives:
	  o Redesign of business processes
	  o Customer service improvements
	
	• Work Planning, Budgeting, Allocation and Control:
	  o Monitoring delivery of major works
	  o Monitoring fault activity.
	  o Monitoring budgets of Inspections and maintenance, faults and major works.
	  o Setting and agreeing performance targets, monitoring actual performance.
	  o Reporting and analysis of Key Performance Indicators ("KPIs").
	
	• Line management of staff undertaking direct activity work:
	  o Standards of performance, disciplinary and sickness absence procedures.
	  o Monitoring absence, back-to-work-interviews and welfare visits.
	  o Establishing day to day work plans.
	  o Managing the allocation tasks to achieve the delivery of operational and capital plans.
	  o Scheduling and monitoring the achievement of work jobs.
	  o Managing budget.
	  o Ensuring work activity adheres to company technical and health & safety requirements.
	
	• Mobile generation Management:
	  o Managing the use of mobile generation.
	  o Managing and scheduling the maintenance of mobile generation.
	
	• Operational Performance Management:

- o Health and Safety checks on work and personnel
- o Compliance checks on staff and contractors work carried out
- o Site safety inspections
- o Providing safety advise to cable contractors and others (to help prevent damage)
- o Investigation, report and corrective action following an accident or environmental incident
- o Authorisation of team members for operational and non-operational duties
- o Operational safety checks

- Providing safety advice to persons working in proximity to network assets.

- Streetworks admin: Customer Funded :
  - o Processing of NRSWA notifications.
  - o Processing the payment of notification penalties (but not the cost of the penalties).
  - o Processing permit applications (but not the costs of the permits).
  - o Processing the payment of permit penalties (but not the cost of the penalties).
  - o Processing payment of inspection penalties (but not the costs of the penalties.
  - o Liaising with local authorities.
  - o Liaising with contractors and direct labour force to undertake remedial works following inspections (but not the cost of the remedial works).
  - o Processing of congestion charges payments (but not the cost of the payments).
  - o Processing of lane rentals payments (but not the cost of the payments).
  - o Processing of overstay fines (but not the cost of the fines).
  - o Updating the Street Gazetteer.

- Wayleave Payments:
  - o Annual payments made in advance to the owner and/or occupier to cover the financial impact of having equipment on their land.

- Wayleaves and Easements/Servitudes: Admin Costs:
  - o Obtaining, managing and administering Wayleave, substation rents, easements and servitudes.
  - o Negotiating new Wayleaves.
  - o Managing Wayleave terminations.
  - o Administration of existing Wayleaves including the preparation of payments.
  - o Negotiation conversions from Wayleave arrangements to permanent easement/ Servitudes, substation rents and Wayleave payments.

- Clerical Support:
  - o Updating plant and overhead line support asset inventory databases following asset commissioning and decommissioning.
  - o Updating plant and overhead line support asset condition data following inspection and maintenance.

- o Dealing with verbal and written enquires for new connections, or faults.
- o Programming of minor works.
- o Issuing of work instructions.
- o Preparation of quotations for minor works.
- o Sending quotations to customers.
- o Customer liaison.
- o Liaising with contractors.
- o Preparing plans, schematics, notices, materials schedules and work instructions.
- o Preparing shutdown notices.
- o Environmental notifications.
- o Clerical support for staff answering verbal and written enquiries regarding faults, liaising with contractors and other stakeholders.

Excludes:
- Any Employees managing indirect activities (eg logistics manager) (include under the relevant indirect activity heading).
- Design work relating to new connections new or replacement assets.
- Responding to NRSWA notices sent to the Company by other parties (include under Systems Mapping).
- Maintenance of mobile generation plant (include under Vehicles and Transport).
- Any employees engaged in maintaining the financial asset register.
- Idle, down and sick time of direct field staff (include with their normal direct time in the appropriate direct activity).
- IT or property costs associated with Engineering Management & Clerical Support.
- Apprentices undertaking classroom training (include under Operational training and workforce renewal)
- Time of employees attending training (include as labour costs under the relevant activity).
- Training courses and training centre costs for staff relating to working on system assets (include under operational training and workforce renewal).
- Engineering and health and safety training, courses for staff involved in indirect activities (include under operational training and workforce renewal).
- Updating of underground cable and overhead line asset data bases (include under System Mapping).
- Updating financial asset register (Finance & regulation).
- Compliance checks on staff and contractors' work carried out.
- Site safety inspections.
- Investigation, report and corrective action following an accident or environmental incident.
- Authorisation of team members for operational and non-operational duties.
- Operational field safety checks.
- Time of employees attending training (include as labour cost under the relevant activity of that employee).
- Purchase of equipment (include under non-operational capex).
- Training, courses and training centre costs for staff relating to working on system assets (include under operational training and workforce renewal).

Network Policy (incl. R&D)	All processes and tasks involved in the development and review of environmental, technical and engineering policies, and including research and development.
	
	Includes:
	• Evaluating the impact of changes in relevant legislation.
	• Development, regular review and updating of asset risk management policies, such as:
	    o asset maintenance policy
	    o asset inspection policy
	    o technical standards and specifications team
	    o plant, equipment and component specifications
	    o vegetation management policy
	    o asset replacement policy
	    o network design and protection policy.
	• Analysis and interpretation of asset condition data.
	• Development, regular review and updating of environmental policy.
	• Research and development (including Fees paid to research and development organisations).
	
	Excludes:
	• Any of the IT or Property costs associated with Network Policy.
	• Excludes IFI related research and development.

Health Safety and Environment	The activity of promoting and maintaining health and safety of employees, contractors, customers and the public.
	
	Includes:
	• Developing the company's overall health and safety policy.
	• Establishing procedures to comply with best practice for health and safety.
	• Maintenance of records to show compliance with Factory and Health and Safety at Work Acts.
	• Providing advice on security matters both for property and personnel and provision of advice on fire prevention.
	
	Excludes:
	• Health & Safety checks on work and personnel such as:
	    o compliance checks on staff and contractors' work carried out
	    o site safety inspections
	    o investigation, report and corrective action following an accident or environmental incident
	    o authorisation of team members for operational and non-operational duties
	    o operational field safety checks
	    o time of employees attending training (include as labour cost under the relevant activity of that employee)
	    o purchase of equipment (include under non-op capex)
	    o training, courses and training centre costs for staff relating to working on system assets (include under operational training)
	    o engineering and health and safety training, courses for staff involved in indirect activities (include under operational training).

Operational Training	Includes operational training and graduate trainees and apprentices.
	Includes training Workforce Renewal new recruit, Operational Upskilling and Operational Refresher Training.
	Operational Upskilling - covers all training (whether classroom based or on-the-job) where employee's skill level is increased in order to undertake activities requiring a higher skill level or to undertake activities requiring a different skill set (eg multi-skilling or redeployment) or the undertake activities via more efficient / effective processes. (Does not cover, eg, routine operational refreshers, and safety briefings, non-operational training courses eg MS Excel, training for CPD purposes once qualified eg accountant).
	Apprentices are engaged under approved apprentice's schemes. Trainees are employed under a formal training programme.
	Includes:
	• Classroom training.
	• On the job training.
	• Trainer and course material/running costs (classroom training).
	• Training admin.
	• Recruitment and external advertising costs for trainees/apprentices.
	• Salaries of apprentices and trainees in full time continuous training up to the point they become fully engaged in operational activities.
	• Costs of staff that organise and provide operational training and maintain employees training records.
	Excludes:
	• HSE costs (include under Health, Safety & Environment).
	• IT & Property management costs associated with Ops Training and Training Centres (include under IT & Property costs respectively).
Stores and Logistics	The activity of managing and operating stores.
	Includes:
	• Delivery costs of materials or stock to stores.
	• Labour and transport costs for the delivery of materials or stock from a centralised store to a satellite store/final location (and vice versa), taking into account the stock management policies.
	• Monitoring stock levels.
	• Quality testing of materials held in stores.
	Excludes:
	• Costs of oil or other insulation medium (report under the activity for which it is used, eg maintenance, faults.
	• Any of the IT systems associated with stores/logistics (include under IT & Telecoms).
	• Any property management and maintenance costs of depots/stores locations (include under property management).
	• Vehicles and Transport - the activity of managing, operating and maintaining the commercial fleet and mobile plant (include under Vehicles and Transport).

Vehicles and Transport	The activity of managing, operating and maintaining the commercial fleet and mobile plant utilised by the Network or any other related party for the purposes of providing services to the Network. Includes: • Lease costs associated with the vehicle fleet and mobile plant. • Maintenance costs of the vehicle fleet and mobile plant, including mobile generation. • Cost of accident repairs to business' own vehicles whether covered by insurance or not and the cost recovery where recovered by insurance. • Fuel costs of the vehicle fleet and mobile plant. Excludes: • Direct field staff time spent on utilising the vehicles for a direct cost activity (include under direct cost activity). • IT & Property costs associated with vehicle management. • Purchases of vehicles, mobile plant and equipment (include under non-op capex). • Cost of providing company cars to employees which are benefits in kind (include as labour cost under the relevant activity of that employee.
Market Facilitation	This covers the following activities: • Network code governance and development. • Proposing and managing industry code modifications. • Generation and demand forecasting. • Information provision to the industry. • Calculation and implementation of Transmission charges.
Network Planning	This covers the following activities: • Asset assurance and management of the asset registers. • Business expert input into IT system development. • Performance monitoring and improvement. • Co-ordination and completion of benchmarking activities. • Control Centre - Operational management and control of the network 　○ Outage planning and management 　○ Real time control and monitoring 　○ Dispatch 　○ Major incidents and emergency planning