

Anna Kulhavy
Ofgem
Commonwealth House
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24 June 2022

Dear Anna,

Consultation on National Grid Electricity Transmission's Enhancing Pre-existing Infrastructure project in the Snowdonia National Park

This letter is National Grid Electricity Transmission's (NGET) response to your consultation on the Snowdonia VIP project. The consultation questions have been replicated below for ease of reference:

Consultation Question 1: Do you agree with our view that NGET has fulfilled its VIP policy commitments?

Consultation Question 2: Do you agree with our view that the Snowdonia EPI project is the valid outcome of NGET working with stakeholders on the selection of EPI projects?

Consultation Question 3: Do you agree with our views on option appraisal carried out by NGET?

Consultation Question 4: Do you agree with our view on the technical scope of the Snowdonia EPI project proposed by NGET?

Consultation Question 5: Do you agree with our cost assessment of NGET's proposed Snowdonia EPI project?

With regard to questions one to four, we agree with your view. On question five, we have provided our views below:

Closely Associated Indirect (CAI) costs

We agree with your view that some of the categories of spend are CAI costs, which will cross over into the next price control period (RIIO-T3). This includes:

- Project management and design work
- Lands, consents and environment
- Legal services
- Stakeholder

To ensure that we are not double paid for these elements, we acknowledge that you have proposed to remove these costs from April 2026 onwards. While we understand the principle of doing this, we do not believe that there is a risk of double counting. This assumes a similar approach to RIIO-T2 is taken in determining CAI allowances in RIIO-T3, namely through econometric benchmarking. We are concerned that the calculation for deriving the opex allowance for RIIO-T3 may not sufficiently cover the allowance that has been removed within this funding submission. The econometric benchmarking was derived using factors associated with the submitted capital plan value and factors assessing our overall network scale. We suggest that these costs are captured within the capital plan in the process of setting allowances for the RIIO-3 price control.

Risk contingency

OHL and shunt reactor risks

We do not agree that the RIIO-2 determinations capped average risk across projects at approximately 7.5%. The Final Determinations ET Annex quoted that historically, risk ranged from 5-25% of the final cost of a project, with the median being close to 10%. The approach to determining an efficient level of asset related risk and contingency was done on a bespoke basis based on the specific project evidence provided by each TO.

We believe that the approach should be to assess each project on its merits. In our submission, we provided a project specific risk register, which was developed with input from specialists.

In the case of the OHL risk register, this input was provided by engineers from Babcock International who were involved in the construction of the existing tower in the estuary. They also developed the methodology for the removal. As such we believe that the contingency value for the OHL works is robust, and reflects the complex nature of the project, which a 7.5% capped average would not.

Similarly, for the shunt reactor scheme, experienced construction engineers reviewed previous installations and site specific constraints at Trawsfynydd to develop a detailed risk register. For this reason we believe the contingency value in the risk register is robust and more appropriate than a 7.5% capped average.

Ground condition risks

We are generally comfortable with your following proposals:

- Include a P50 allowance for our ground related risks apart from two that are high impact, low probability (HILP).
- Removal of our requested P20 allowance for ground risks.
- Introduce a Cost and Output Adjusting Event (COAE) for the 2 HILP risks (threshold to be set at 10% of the total ground risks).

Other risks

- Removal of four HILP risks and include within a reopener.
- COAE threshold to be set at 10% of the total non ground risks.

We believe the reopener is a good approach to dealing with the HILP risks and agree with the 10% threshold for triggering the COAE.

Due to the different price bases used within the submission, we would welcome a further discussion with you to clarify the calculations.

Real Price Effects (RPE)

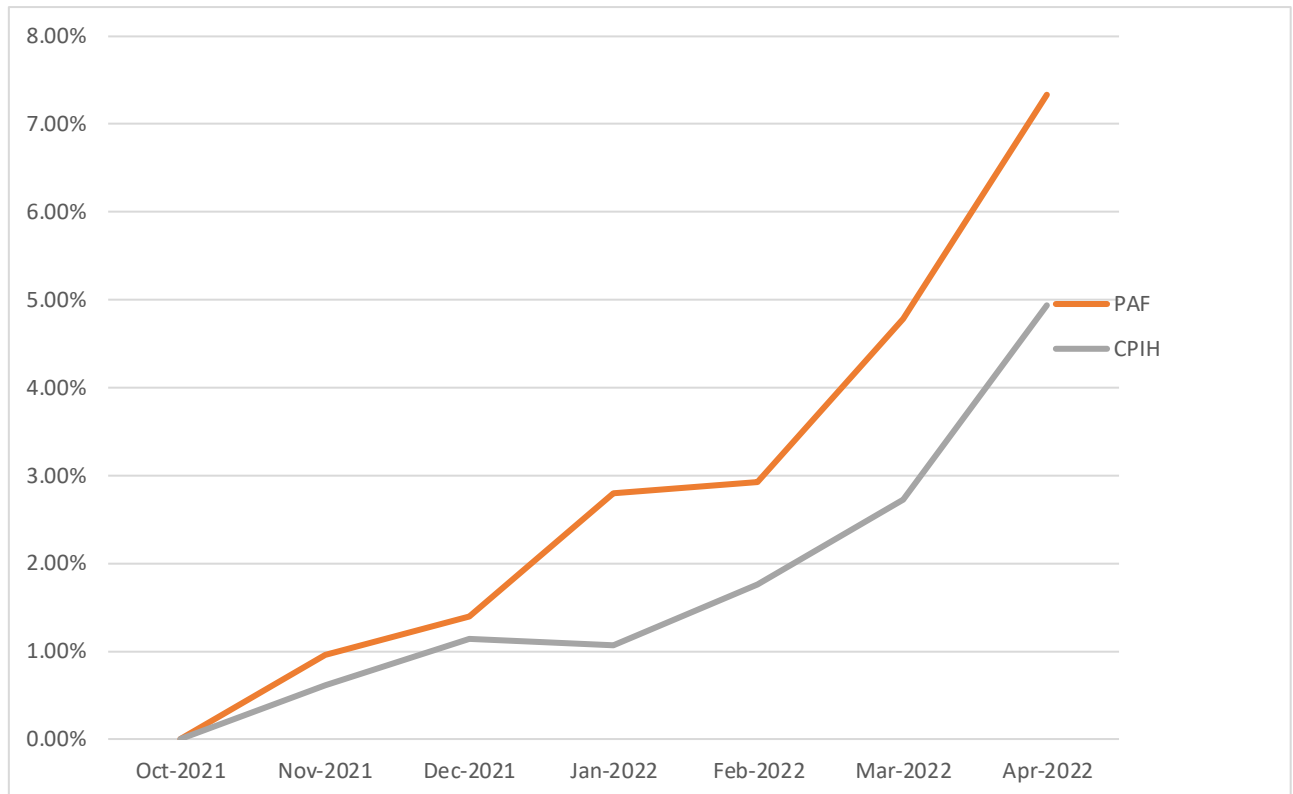
As you have noted in your consultation, *“it is likely that there will be a difference between construction input prices and general inflation for some time during RIIO-2.”*

In our funding submission, we requested that Ofgem consider replicating an existing mechanism to provide an indexation approach to cover the difference between construction price increases and inflation. This currently applies to existing projects that were agreed as part of the RIIO-2 baseline. It is still our view that applying such a mechanism, whether annually or at project closure, would protect both us and consumers from windfall gains and losses. We would welcome a discussion on how this could be implemented within our licence as it is not clear on what the barriers are for doing so.

In light of the unprecedented recent increase in inflation, we have updated our original calculation of the RPE risk. We believe that the £0.9m proposed allowance will not be adequate. Based on our latest forecasts, our analysis shows that the difference between CPIH and PAFI equates to an additional value of £7.1m compared to our previous forecast of £1.3m. If we apply a P50 estimate to this, it comes to £5.3m (19/20

prices). We have attached our calculations in a separate appendix as this contains confidential price information that can not be published.

An updated chart containing the difference in the indexes can be found below. There has been a much greater separation of the indexes than we originally forecast. As reported by the BCIS¹, the pressure on the construction supply chain and labour shortages have become more significant. Their forecast is that the BCIS materials index will grow by 7.4% in December 2022 compared to December 2021.



We hope this provides sufficient information to answer your questions. We would welcome a discussion with you on these topics if that would be helpful.

Yours sincerely

Pat Hynes
Regulation Manager

¹ <https://bcis.co.uk/news/material-cost-increases-may-22/>