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8<sup>th</sup> March 2023

Dear Phil

**Consultation response from National Grid Electricity Transmission Plc on the following Large Onshore Transmission Investment Project Assessment; Dinorwig – Pentir.**

Thank you for the opportunity to respond to the above consultation on behalf of National Grid Electricity Transmission Plc (NGET). This letter provides a summary of our response, with the full detail included as a confidential Appendix 1. Given the commercially sensitive nature of some areas of our response Appendix 1 should be treated as confidential.

We do not agree with several of the proposed reductions that Ofgem have set out in the cost allowance section of the consultation. In this response letter we have set out our high-level position.

Our high-level position on the topics in Ofgem's proposed project assessment are as follows:

**Treatment of scrap proceeds**

- We disagree with Ofgem's proposed position on scrap. The proposal is inconsistent with the policy set out in Final Determinations (FDs)<sup>1</sup>. We maintain this should be treated as a negative Totex adjustment in line with the FDs.
- The proposed treatment also creates additional risk for network owners that is not funded.
- We also note Ofgem have stated that the level of scrap is firm, however we would like to clarify that the value we have provided is only an estimate.
- The proposed treatment is not reflected in the Regulatory Instructions and Guidance (RIGs), Price Control Financial Model (PCFM) or Regulatory Reporting Process (RRP) and could lead to further negative adjustments if reported as proposed by these.

**Site accommodation**

- NGET disagrees with Ofgem's position to reduce funding in respect of on-site accommodation. The reduction is in relation to the compound required between the main compound and the cables. These costs have been removed from the contractors Activity Price Schedule (APS) and are instead being paid directly by NGET as a matter of efficiency. As it has not been included in the contractor request it cannot therefore be disallowed, therefore the disallowance is an error.

**Contractor fees**

- We agree with the Ofgem calculation to remove the contractor fee on the disallowed costs for from the contractor APS's. However, we believe that the site accommodation disallowance is incorrect as this has been already removed from the revised September 21 MS APS's. We recognise that the value of disallowance for the contractor fee may change based on Ofgem's position after NGET provided the APS extract as evidence.

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<sup>1</sup> See the policy set out by Ofgem within Final Determinations, Finance Annex Revised paragraph 11.32.

## Cable spares

- As this is a new project and not a replacement for an existing project, these are additional spares not funded through the baseline allowance. Therefore, we disagree with Ofgem's proposed position.
- The additional spares here are initially a risk mitigation measure.
- The baseline funding is for stock replenishment: i.e., replacement of existing strategic spares that are consumed to resolve faults and failures on the network<sup>2</sup>.

## Project management and overheads

- We do not agree that there are duplicated roles between the Project Management and overhead costs as suggested by Ofgem. The headings may seem similar; however, the actual activities being undertaken are different, this can be clearly evidenced from the actual costs which we have been incurred to date on this project.
- Since the consultation we have shared further evidence that we believe demonstrates that the roles are not duplicated.

## NGET and contractor risks and SHR risk

- We maintain that the percentage applied should be 12% as derived using the industry standard P50 risk assessment process.
- We do not agree with the top-down approach of applying 7.5% as a cap. In Final Determinations the range quoted for risk was 5% to 25% with a median of 10%<sup>3</sup>. Therefore, we do not recognise the 7.5% that is being used as a cap.
- Notwithstanding that we do not agree with the 7.5%, it is mathematically unsound to use an average figure as a cap.
- This project is a highly complex project which involves extensive work in confined space on third party land, using new SF6 free technology, and with exposure to adverse weather conditions. Working conditions in a cavern and mountainous area, which is also a National Park, is not standard practice and has complex stakeholder and contractual arrangements which requires significant proactive management. Given the unique nature of the project, risks should be assessed at the detailed risk level to ensure the complexities are given the required consideration. Therefore, we maintain that as a complex project the risk will be higher than the median which we recognise as 10% from the FDs.
- We do not agree with the top-down approach. However, if a top-down approach is applied, the percentage should be against the total project cost for Dinorwig-Pentir excluding risk value, rather than what has been applied in the consultation document. Currently, the percentage has been applied to the cost of project less:
  - Risk
  - Overhead & Project Mgt. Costs
  - Previous funding received by NGET
  - Scrap Rebate disallowance

The calculation of any top-down percentage must be consistent with the data that it was derived from.

- In the consultation Ofgem suggest that if a bottom-up assessment were to be carried out several risks would be automatically excluded. We do not agree with this approach as automatically excluding risks, such as interface risk, would have perverse negative incentives for future contracting strategies. Where a TO chooses multiple contracting LOTs to maximise competition and de-risk delivery the resulting interface risk must be recognised.

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<sup>2</sup> This is explicit in our approved submission (A9.18).

<sup>3</sup> Risk and contingency costs

3.21 When setting out their LR and NLR capex project cost forecasts, it is prudent for ETOs to include an additional amount, known as risk and contingency, to cover events outside of their direct control, e.g., significantly adverse weather, failure of suppliers to meet their contractual commitments, or late delivery of key components. Historically, these costs have tended to range from 5 - 25% of the final cost of a project, with a median close to 10% of the final cost.

## **Pain / gain exposure**

- We accept the suggested mechanism to recover pain should it be incurred via a Cost and Output Adjusting Event (COAE). However, the pain threshold of £2.8m would not cover the full exposure that NGET could be liable for. This COAE should be capped to cover the total exposure for NGET. The £2.8m figure has been misused in this context. It was an estimated position of pain based on historical industry benchmarks and was a suggestion of an up-front allowance Ofgem would provide for NGET to hold the risk of any further pain.
- We fundamentally disagree with option 1, that our exposure should be passed through TIM. TIM is an efficiency incentive for networks to reduce costs below the deemed efficient level of allowance<sup>4</sup>. TIM should only be used where the company has agreed to take on risk for a set allowance, it is not a replacement for an allowance.

## **Commodity Exposure**

- We have provided detailed calculation behind the £3.8m figure as requested on 17th January 2023. We met Ofgem on 6th February 2023 to explain the information provided. We believe Ofgem has accepted the evidence and agreed for it to be treated as a COAE adjustment. Due to uncertainty of this type of costs, these costs should not be capped.
- Based on the information provided, we ask Ofgem to reconsider their position on this topic.

We note that Ofgem has included within its consultation both the licence statutory consultation and the wider Project Assessment proposal. Ordinarily we would have expected engagement on the Project Assessment proposal first, followed by consultation in relation to the licence changes such that required changes to the proposed licence drafting at that stage is minimal. We have therefore provided our comments on the proposed licence drafting in Appendix 1, but we would welcome Ofgem's further consultation on the licence drafting before any such amendments are directed.

We have provided detail responses in Appendix 1 to Question 2 on the proposed outputs and delivery dates for the Dinorwig-Pentir project and Question 3 on the proposed modifications to the NGET licence required as part of the implementation of the Dinorwig-Pentir Project.

If you require any further information regarding this response, or wish to discuss anything, please do not hesitate to contact Devinder Khangura, [devinder.khangura@nationalgrid.com](mailto:devinder.khangura@nationalgrid.com) .

Yours sincerely,

[By email]

Patrick Hynes

New Infrastructure Regulation Manager, National Grid

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<sup>4</sup> [Handbook for implementing the RIIO model \(ofgem.gov.uk\)](https://www.ofgem.gov.uk/handbook-for-implementing-the-riio-model)