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Dear Sai Wing Lo,

Response to Ofgem's Consultation on the assessment of three Medium Sized Investment Projects from SP Transmission plc (SPT)

This response is made on behalf of National Grid Electricity Transmission plc (NGET). We welcome the opportunity to respond to the consultation on the assessment of three Medium Sized Investment Projects (MSIP) from SPT published on 9 October 2023. Ofgem is consulting on its assessment of the needs case, optioneering, and efficient costs for three 'full submissions'. There are four matters upon which we wish to respond.

1. Application of the Opex Escalator

On the matter of the application of the Opex Escalator (OE), we fundamentally disagree that the OE was established in such a way as to fund contractor 'indirects' as Ofgem states in the consultation . As a result, Ofgem's approach to reclassifying contractor 'indirects' and removing them from SPT's forecast direct capex when determining direct capex allowances is seriously flawed and is a significant and clear departure from the T2 price control settlement. We do not repeat here the points that we have previously made (both individually and in joint letters from the ETOs) in relation to Ofgem's application of the OE in the context of NGET's 2022 MSIP submissions . However, we would note that Ofgem's recent NGET licence modification decision¹ (dated 6 October 2023) in relation to these submissions states that "there is potential for outturn funding provision to differ from efficient levels" and (in the draft principles for the proposed OE review mechanism forming part of the decision) that:

"We agree that the treatment of Contractor Indirects in the calibration of the OE may make it more likely than it would otherwise have been had better data been available at the time, that CAI allowances provided to ETOs through the OE will not align with the efficient levels."

¹ <https://www.ofgem.gov.uk/publications/decision-modify-special-conditions-electricity-transmission-licence-held-national-grid-electricity-transmission-plc>

As a consequence, in its 6 October 2023 NGET licence modification decision Ofgem has proposed the introduction of a true-up methodology for the end of the RIIO-T2 period to “to identify ex post whether the OE mechanism has systematically provided lower Closely Associated Indirect (CAI) Allowances than ex post assessed efficient levels [...], and in such cases to adjust allowances to an efficient level once all costs are known with sufficient accuracy”. Although Ofgem’s proposed draft principles for this review mechanism are currently unworkable in practice and include excessively restrictive eligibility criteria, we look forward to working constructively with Ofgem and the other ETOs impacted by Ofgem’s application of the OE to implement a workable mechanism such that this funding gap can be appropriately addressed.

2. Treatment of forecast costs for risk and contingency

In the consultation, Ofgem refer to a benchmark level of 7.5% of the direct costs of a project for risk and contingency. This benchmark is relied upon to set allowances but its derivation is not evidenced, and therefore it is impossible for ETOs to provide ‘compelling evidence’ of a risk being outside the scope of comparable projects (because we do not know what was in the scope of the project risks that made up the 7.5% benchmark). We request that Ofgem share the detailed derivation of the 7.5% benchmark in order that ETOs can better compare the risks on re-opener projects with those that set the RIIO-T2 benchmark.

We also observe that Ofgem’s treatment of contractor ‘indirects’ means that the 7.5% ‘risk cap’ is now being applied to a view of direct capex that is net of contractor ‘indirects’ whereas, if the 7.5% was established based on RIIO-T2 Business Plan Data Table or Final Determination data, that would have included contractor ‘indirects’ as direct capex. Consequently, the 7.5% risk cap is being applied inconsistently with how it was set and will systematically provide less funding than it ought.

Finally, we disagree that such capping of risk costs should be referred to as a ‘cost efficiency’ in the Ofgem tables.

3. Two-stage approach for MSIP applications

We note that the current consultation (at footnote 3) refers to Ofgem’s informal consultation on the Initial Needs Case for five of SPT’s 2023 MSIPs. In paragraph 1.12 of the informal consultation², Ofgem state that it wants to see MSIP applications covering both need case and allowances together (i.e. to remove the two-stage approach). This is the same position as that stated in Ofgem’s Initial Needs Case decision on our 2023 MSIPs (published on 4 October 2023), paragraph 2.11 of which states:

“As mentioned in the consultation, it should be noted that although we accepted and assessed some initial needs case submissions during the 2022 and 2023 MSIP submission windows without cost assessment information, we expect that future MSIP submissions will include all the

² Informal consultation on the assessment of five 2023 Medium Sized Investment Project initial needs case submissions from SP Transmission (ofgem.gov.uk)

information necessary for us to assess both the need for the projects and the efficient costs together.”

This expectation is at odds with paragraph 1.10 of the informal consultation which acknowledges the benefits that the flexible staged MSIP application submission approach offers:

“As mentioned above, the MSIP re-opener has been designed to allow ETOs to submit applications when there is more certainty over both needs and costs. Initial needs case submissions seek agreement in principle for the initial needs case and preferred option ahead of the full application.”

The staged approach adopted during the 2022 and 2023 MSIP submission windows facilitates early engagement with Ofgem on the initial needs case ahead of the assessment of final needs case, project costs and associated allowances. This provides consumer benefit and facilitates the timely delivery of investments by the ETOs. We would therefore strongly urge Ofgem to retain the two-stage MSIP submission approach in order to retain these benefits and facilitate the timely delivery of investments required to meet Net Zero targets.

4. Publication of commercially sensitive cost information

On a more generic matter, we note that the original publication of this consultation included commercially confidential information in the form of overly-detailed cost tables. Whilst we are pleased that Ofgem reacted quickly and redacted the inappropriate level of detail, arguably the ‘damage is done’ because the original version has the potential to adversely affect competitive processes going forward. It is disappointing that this issue recurs, and especially important that it should not recur for future Ofgem publications (e.g. those associated with forecast RIIO-T3 plans). We politely request that Ofgem increase its diligence and controls in this area.

This response is not confidential.

If you would like to clarify anything in this response please do not hesitate to contact either myself or Michelle Clark (michelle.clark@nationalgrid.com).

We hope that you find this response useful and constructive.

Yours sincerely,



Chris Bennett
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(by email)