

# Consultation

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## SGN Non-Operational IT Capex Re-opener Draft Determination

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Contact:	Rebecca Taig
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Team:	Networks
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Telephone:	020 7901 7059
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Email:	rebecca.taig@ofgem.gov.uk
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We are consulting on SGN's Non-Operational Information Technology (IT) Capex Re-opener submission, which was submitted in the 28 August 2023 to 15 September 2023<sup>1</sup> Re-opener window.

We particularly welcome responses from people and companies with an interest in electricity and gas transmission or distribution. We also welcome responses from other stakeholders and the public.

This document outlines the scope, purpose and questions of the consultation and how you can get involved. Once the consultation is closed, we will consider all responses. We want to be transparent in our consultations. We will publish the non-confidential responses we receive alongside a decision on next steps on our website at [ofgem.gov.uk/consultations](https://www.ofgem.gov.uk/consultations). If you want your response – in whole or in part – to be considered confidential, please tell us in your response and explain why. Please clearly mark the parts of your response that you consider to be confidential, and if possible, put the confidential material in separate appendices to your response.

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<sup>1</sup> This is an additional authority triggered window for the Non-Operational IT Capex Re-opener. The original fixed window within the licence was 23 January 2023 to 30 January 2023. [Direction for New IT and Cyber Re-opener Windows 2023 \(ofgem.gov.uk\)](https://www.ofgem.gov.uk/direction-for-new-it-and-cyber-re-opener-windows-2023)

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# 1. Introduction

## Section summary

This section provides an explanation of SGN's submission, our assessment process, and how we will handle this consultation process.

## Introduction to RIIO-2

- 1.1 Network companies are natural monopolies. Effective regulation of privatised for-profit monopolies is essential to ensure they cannot unfairly exercise their monopoly power to the detriment of their customers. This is particularly important in the case of essential utilities, such as energy, where consumers have no choice on whether or not to pay what they are charged. It is therefore crucial that an effective regulator protects energy consumers by controlling how much network companies can charge their customers. Ofgem does this through periodic price controls that are designed to ensure network companies are properly incentivised to deliver the best possible outcomes for current and future energy consumers. This includes ensuring that consumers only pay for investments that are needed and do not overpay for those investments.
- 1.2 The current price control model is known as RIIO (Revenue = Incentives + Innovation + Outputs). RIIO-2 is the second price control under the RIIO model for electricity transmission, gas transmission and gas distribution, and runs from 1 April 2021 until 31 March 2026. It includes a range of Uncertainty Mechanisms (UMs) that allow us to assess applications for further funding during RIIO-2 as the need, cost or timing of proposed projects becomes clearer. This ensures that consumers fund projects only when there is clear evidence of benefit, and we have clarity on likely costs and cost efficiency. These mechanisms also ensure that the RIIO-2 price control has flexibility to adapt as the pathways to Net Zero become clearer.
- 1.3 Where possible, we have set automatic UMs, such as the Generation and Demand Connection Volume Drivers, which provide some network companies with immediate funding when they are required to undertake new customer connection works. In other areas, where the degree of uncertainty is too great to allow for an automatic mechanism, we set 're-openers' which will allow us to assess proposals robustly once information with sufficient accuracy is made available.

- 1.4 The Non-Operational IT Capex Re-opener provides network companies with specific windows<sup>2</sup> within the RIIO-2 period where they can request additional funding for new and replacement IT assets, including hardware, infrastructure, and software development projects, some of which may be critical for achieving Net Zero.

## **What are we consulting on?**

- 1.1 We<sup>3</sup> are consulting on adjusting SGN's Non-operational Information Technology (IT) Capital expenditure (Capex)<sup>4</sup> outputs and allowances under the RIIO-2 Non-operational IT Capex Re-opener ("the Re-opener").
- 1.2 In accordance with Special Condition 3.7 (Non-operational IT Capex Re-opener) of SGN's licence, SGN has applied to Ofgem to add additional allowances for Non-operational IT projects into its RIIO-2 price control framework. SGN submitted an application titled "HR Transformation to address the recruitment, development, and retention challenges of the UK labour market".
- 1.3 Throughout this document, all monetary figures are in 2018/19 prices (to align with the original RIIO-2 price base).

## **Consultation approach**

- 1.4 We are issuing this consultation following our assessment of SGN's re-opener application. This document explains our assessment of that application and the adjustments we are proposing to make to SGN's licence, including adjustments to allowances and the addition of any Price Control Deliverables (PCD).
- 1.5 We considered SGN's application and its justification for the funding requested in accordance with our principal objective and statutory duties. In line with the Re-opener Guidance and Application Requirement Document<sup>5</sup>, our assessment of each project covers the three following areas:
- the needs case
  - the options assessment and the justification for the proposed project

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<sup>2</sup> See footnote 1 above

<sup>3</sup> The terms "we", "us", "our", "Ofgem" and "the Authority" are used interchangeably in this document and refer to the Gas and Electricity Markets Authority. Ofgem is the office of the Authority.

<sup>4</sup> Expenditure on new and replacement IT assets, including Hardware & Infrastructure and Application Software Development

<sup>5</sup> [Re-opener Guidance and Application Requirements Document: Version 3 | Ofgem](#)

- the efficient costs for the proposed project

We rely on our assessment of these 3 areas in coming to our Draft Determination on what additional allowances, if any, should be provided to SGN to undertake the project.

### Context and related publications

1.6 The scope of this consultation is limited to SGN's Non-operational IT Capex Re-opener. This document is intended to be read alongside:

- the RIIO-2 Draft Determinations – Core Document, Chapter 7<sup>6</sup>
- the RIIO-2 Final Determinations – Core Document (REVISED), Chapter 7, page 78<sup>7</sup>
- SGN's Licence Special Conditions 3.7<sup>8</sup>
- RIIO-2 Re-opener Guidance and Application Requirements Document<sup>9</sup>.

### Consultation stages

**Figure 1: Consultation stages**

Stage 1	Stage 2	Stage 3	Stage 4
Consultation open	Consultation closes (awaiting decision). Deadline for responses	Responses reviewed and published	Consultation decision
14/02/2024	13/03/2024	May 2024	May 2024

### How to respond

- 1.7 We want to hear from anyone interested in this consultation. Please send your response to the person or team named on this document's front page.
- 1.8 We've asked for your feedback in each of the questions throughout. Please respond to each one as fully as you can.

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<sup>6</sup> [RIIO-2 Draft Determinations - Core Document \(ofgem.gov.uk\)](#)

<sup>7</sup> [https://www.ofgem.gov.uk/system/files/docs/2021/02/final\\_determinations\\_-\\_core\\_document\\_revised.pdf](https://www.ofgem.gov.uk/system/files/docs/2021/02/final_determinations_-_core_document_revised.pdf)

<sup>8</sup> [Special Conditions - GD - Southern Gas Networks.pdf \(ofgem.gov.uk\)](#)

<sup>9</sup> See footnote 4 above

- 1.9 We will publish non-confidential responses on our website at [www.ofgem.gov.uk/consultations](http://www.ofgem.gov.uk/consultations).

## **Your response, data and confidentiality**

- 1.10 You can ask us to keep your response, or parts of your response, confidential. We'll respect this, subject to obligations to disclose information, for example, under the Freedom of Information Act 2000, the Environmental Information Regulations 2004, statutory directions, court orders, government regulations or where you give us explicit permission to disclose. If you do want us to keep your response confidential, please clearly mark this on your response and explain why.
- 1.11 If you wish us to keep part of your response confidential, please clearly mark those parts of your response that you *do* wish to be kept confidential and those that you *do not* wish to be kept confidential. Please put the confidential material in a separate appendix to your response. If necessary, we'll get in touch with you to discuss which parts of the information in your response should be kept confidential, and which can be published. We might ask for reasons why.
- 1.12 If the information you give in your response contains personal data under the General Data Protection Regulation (Regulation (EU) 2016/679) as retained in domestic law following the UK's withdrawal from the European Union ("UK GDPR"), the Gas and Electricity Markets Authority will be the data controller for the purposes of GDPR. Ofgem uses the information in responses in performing its statutory functions and in accordance with section 105 of the Utilities Act 2000. Please refer to our Privacy Notice on consultations, see Appendix 1.
- 1.13 If you wish to respond confidentially, we'll keep your response itself confidential, but we will publish the number (but not the names) of confidential responses we receive. We won't link responses to respondents if we publish a summary of responses, and we will evaluate each response on its own merits without undermining your right to confidentiality.

## **General feedback**

- 1.14 We believe that consultation is at the heart of good policy development. We welcome any comments about how we've run this consultation. We'd also like to get your answers to these questions:
1. Do you have any comments about the overall process of this consultation?
  2. Do you have any comments about its tone and content?
  3. Was it easy to read and understand? Or could it have been better written?

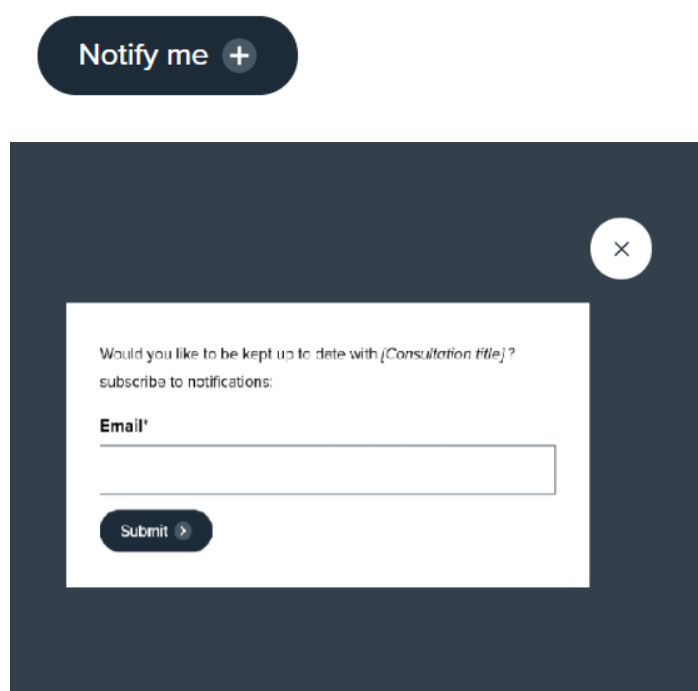
4. Were its conclusions balanced?
5. Did it make reasoned recommendations for improvement?
6. Any further comments?

Please send any general feedback comments to [stakeholders@ofgem.gov.uk](mailto:stakeholders@ofgem.gov.uk)

## How to track the progress of the consultation

You can track the progress of a consultation from upcoming to decision status using the 'notify me' function on a consultation page when published on our website.

[Ofgem.gov.uk/consultations](https://www.ofgem.gov.uk/consultations)



The image shows a dark blue button labeled 'Notify me' with a white plus sign. Below it is a dark blue modal box with a white close button (X) in the top right corner. Inside the modal box is a white form with the text: 'Would you like to be kept up to date with [Consultation title]?' followed by 'subscribe to notifications:'. Below this is a label 'Email\*' and a text input field. At the bottom of the form is a dark blue button labeled 'Submit' with a white right-pointing arrow.

Once subscribed to the notifications for a particular consultation, you will receive an email to notify you when it has changed status. Our consultation stages are:

**Upcoming** > **Open** > **Closed** (awaiting decision) > **Closed** (with decision)



## **2. 'HR Transformation to address the recruitment, development, and retention challenges of the UK labour market' Project**

### **Section summary**

This section outlines SGN's re-opener application for its 'HR Transformation' project and its submission on the needs case.

### **SGN's demonstration of the needs case**

- 2.1 SGN's submission details SGN's proposals to modernise its HR capabilities. SGN suggest that the proposed modernisation is urgent and necessary to enable it to adjust to unprecedented and unforeseen circumstances such as COVID-19 and what SGN calls an ensuing "great resignation"<sup>10</sup>. SGN has stated that the combination of these circumstances has altered how existing employees and potential recruits must be handled. In addition, SGN has noted that such circumstances have had impacts on its ability to recruit, train and retain competent staff in the volumes required to continue to meet its licence obligations.
- 2.2 SGN had proposed in its business plans that an evolution of core HR processes and systems was expected to be necessary across RIIO-GD2. SGN stated it underwent a series of upgrades to the core HR processes, in early GD2, to ensure resiliency of the tooling. However, these upgrades were not to the extent and pace required to mitigate the impact of the above circumstances. Therefore, the required scope of modernisation, in SGN's view, has now outgrown the capability of its current teams and systems.
- 2.3 SGN explained that its current HR system requires radical modernisation to enable high volume recruitment and competency assurance. For example, SGN stated it has experienced a 700% uplift in recruitment related activities post-COVID compared to pre-COVID. SGN's current process model used for recruitment, retention and capability development is based on a historical standard of specialist resources in long tenure with the organisation. Its processes and systems mirror this historical model and are scaled for low volume

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<sup>10</sup> (undefined by SGN)

- recruitment with heavily manual processes to maintain competency, develop skills and day to day admin of active employees.
- 2.4 In addition, SGN stated the current model used to maintain competency monitors compliance and pro-actively reassesses an already skilled workforce, rather than assess and prove competency of new hires before being able to operate on its network. SGN explains the management of its recruitment and training in the volumes now required to maintain a safe and reliable network is key to meeting its licence obligations for the remainder of GD2.
- 2.5 SGN notes it historically enjoyed long term stability and low turnover of resources, which minimised the inherent risk with manual data entry and processing. However, SGNs systems are still reliant on manual data entry and processing coupled with higher volume throughput and greater pace required for these processes which induces significant risk from human error and thus implicates data integrity.
- 2.6 SGN states it is essential for its workforce to be skilled and compliant to maintain a reliable service. SGN explains it requires better visibility and quality of recorded data to maintain integrity and to pro-actively plan training outside of peak times. This is to ensure best availability of skilled and competent resources at highest demand, allowing SGN to better serve its customers at peak times.
- 2.7 SGN wants new or innovative training courses and materials to address the demand of an evolving workplace and maintain a competent workforce for key roles. For example, SGN stated operational roles are increasing in complexity of skills required for SGN to move towards net zero.
- 2.8 In addition to recruitment and training, SGN has explained there has been a decline in staff retention, particularly in its core front line resources which introduces risk to SGNs ability to operate a safe and resilient supply. In addition to external factors is an aging workforce. SGN has stated there is a large proportion of its staff reaching retirement ages which outweighs the proportion of new recruits coming into the industry. To address this SGN has stated it requires refocusing of its employment and development strategy to utilise an apprenticeship-based recruitment model which is aimed to help combat a reduction in applicants for its operational roles and to develop potential talent from within.
- 2.9 In particular, SGN has stated that many of its maintenance operatives are nearing retirement. SGN acknowledges it has several critical, complex maintenance processes which are conducted annually. These maintenance checks

require appropriate knowledge and experience to be conducted and SGN recognise it is at risk of losing critical expertise and skill. To retain knowledge and expertise SGN has stated it needs:

- A way to record physical protocols to execute these processes.
- A way to train new maintenance operatives in how to execute the process correctly considering health and safety protocols.
- An audit train of the training and any tests passed.
- An interactive guide which is available onsite to demonstrate asset features and materials and step through each process.

2.10 SGN has explained the marketplace has evolved faster than its current recruitment, onboarding, development and retention processes can manage. To guarantee business continuity and service resilience, SGN has proposed two key areas of focus:

- Recruitment, Onboarding, and Retention
- Learning and Development (L&D)

2.11 SGN has proposed a plan to enhance capabilities across its HR and L&D estate including:

- Expediting volume recruitment through expansion of its current back-office HR systems to handle bulk candidacy assessment and onboarding.
- Digitalising knowledge retention and ensuring competency assurance in new recruits through state of the art, modern learning tools such as AR/VR.
- Reversing high employee attrition through modernisation and self-service within its digital platforms in areas of payroll, L&D, and absence reporting.
- Improving visibility of core HR and L&D data through alignment and opening up of core HR data to reporting platforms in line with its open data commitments.

These enhancements are aimed to ensure continued safety and resilience of SGN's service. SGN wants these improvements to create a better work environment for current and new recruits, attract quality candidates and better compete in an increasingly digital world.

2.12 Finally, SGN wants to enhance its current work environment and experience for its employees. SGN recognises its employees expect flexible work patterns with

more incorporation of digitalisation within its role, more flexibility in training methods and tools, and more options for progression.

### 3. Our Draft Determination

#### Section summary

This section outlines SGN's re-opener application for its 'HR Transformation' project and our assessment of the needs case, optioneering and costs. Based on this assessment we have formed our Draft Determination of what allowances, if any, should be added for this project.

#### Questions

Q1. Do you agree with our Draft Determination?

- 3.1 We noted from its submission that SGN is looking to learn lessons and address the impacts stemming from COVID-19 and subsequent high attrition rates. In particular, SGN wants to address its current inability to bulk recruit and boost its staff retention by augmenting system capabilities across its HR and L&D estate.
- 3.2 We can see in its presented need case SGN's intention to overcome and future-proof its business going forward. We can also see that from an efficiency perspective, increasing digitalisation within the business would be advantageous. However, we cannot see that upgrades of the scale proposed are required in RIIO-GD2. We have set out the rationale for our view below.
- 3.3 SGN stated that it implemented a series of upgrades, in early GD2, to the core systems involved with HR processes. SGN has reported that these upgrades ensured resilience of the tooling throughout GD2, thus maintaining the safe, secure services under its licence obligations. This was in addition to offering a solid foundation on which to enhance the offering to support an evolving workforce landscape. But it is unclear to us what the benefits of these upgrades were, and therefore what the scale of the 'gap' between business-as-usual investment is and what SGN has already implemented. This makes it harder for us to understand what benefits additional investment would achieve in this area.
- 3.4 Critically, as SGN has mentioned in its submission, COVID-19 has had an unprecedented influence across the industry. More widely, there has been an industry and economy wide movement to adjust and mitigate impacts from COVID-19. We sympathise with SGN that these circumstances were not anticipated and may have driven a larger 'gap' to bridge in modernising its HR capabilities than it anticipated during its RIIO-2 business planning.

- 3.5 In addition, SGN's need case is not clear on how the drivers of this work, such as the discussion of a "great resignation", lead to outcomes that will be adequately addressed by its proposal. For example, there is significant discussion of how SGN intends to improve its retention of staff, but it is not clear how a better HR system will lead to improved retention.
- 3.6 Critically, there is no explicit mention of what the benefits are, or the scale of the benefits, to consumers and other stakeholders. Whilst we appreciate there would likely to be a knock-on impact from SGN's proposals, we expect a strong correlation of the needs case to the benefits to consumers for additional allowances to be awarded.
- 3.7 Overall, in its needs case we can see SGN wants to retain valuable employees, their knowledge and expertise, improve recruitment, onboarding and training of new staff and increase its use in digitalisation to add business value and align with open data commitments. However, we are not convinced by SGNs justification of the root causes towards these adjustments. In addition, it is not clear the scale of adjustments required after the early GD2 modernisation of SGNs HR capabilities. Fundamentally, SGNs needs case does not demonstrate the benefit for consumers, stakeholders and wider society.
- 3.8 As part of our holistic assessment, we have reviewed the options and costs presented in SGNs submission. SGN presented three options to address the needs case:
1. do nothing,
  2. enhance its existing back-office supporting systems, and
  3. replace its core supporting systems and re-engineer its back-office estate.
- 3.9 SGN rejected the options to 'do nothing' and to 'replace and re-engineer' as they would both drive higher costs. In particular, the 'do nothing' option was rejected because SGN states its current recruitment, onboarding, development and retention processes have been outpaced by a marketplace that is evolving much faster than it can develop, and that delaying investment would entail higher costs to bridge a larger, growing gap as it approaches GD3. SGN's preferred option is to build onto its core foundation stating it would be the most cost effective, timely and pragmatic response to addressing its need case. However, we disagree with SGNs assessment of its optioneering. The need case details prior upgrades that continue to ensure resilience and maintains safe, secure services under its licence obligations. Additionally, we do not have details of what SGN has already implemented. This makes it difficult for us to assess what benefits would come

from additional investment. More importantly, SGN has not stated what the benefits are or their scale towards consumers and other stakeholders. For these reasons, we consider the 'do nothing' option the best option for consumers.

- 3.10 In terms of costs, SGN is requesting a total investment of £7.42 million (£7.06 million CAPEX, £0.36 million OPEX), including a risk allowance of £1.43 million (19% of total investment).
- 3.11 The costs presented are largely driven by spending on external contractor staff and third-party costs, with no internal staff expected to be used on this project. SGN states in its needs case there is an urgent need for change. We appreciate it takes time to hire roles internally and to build up expertise. However, this approach is expensive and is not sustainable to support an evolving workplace, so does not appear to represent good value for money for consumers. The requested risk allowance is high compared to comparable projects, at almost 20%, which suggests that the project is not of sufficient maturity.
- 3.12 We consider that the benefits of this project have not been clearly demonstrated and the costs appear high. In addition, the needs case does not clearly present previous upgrade efforts and its contribution to minimise costs presented in this submission. We are therefore minded to reject the application to fund the delivery of the HR Transformation project.
- 3.13 Our Draft Determination is to reject the needs case as it has been presented and therefore to reject the full amount requested (£7.42m).
- 3.14 If SGN considers that this project is still worth pursuing, we recommend that it builds into its business case for the next price control period two crucial elements:
- A clear explanation of the benefits for consumers for funding this project.
  - Explanation of how costs will be minimised to drive maximum value.
- 3.15 **Table 1** below details SGN's requested funding, our proposed reductions, and our proposed allowances, if any.

**Table 1:** SGNs requested funding and our Draft Determination

SGN proposal	Ofgem adjustments	Draft allowances
£7.42m	-£7.42m	£0.00m





## **Appendix 1 - Privacy notice on consultations**

### **Personal data**

The following explains your rights and gives you the information you are entitled to under the General Data Protection Regulation (GDPR).

Note that this section only refers to your personal data (your name address and anything that could be used to identify you personally) not the content of your response to the consultation.

#### **1. The identity of the controller and contact details of our Data Protection Officer**

The Gas and Electricity Markets Authority is the controller, (for ease of reference, "Ofgem"). The Data Protection Officer can be contacted at [dpo@ofgem.gov.uk](mailto:dpo@ofgem.gov.uk)

#### **2. Why we are collecting your personal data**

Your personal data is being collected as an essential part of the consultation process, so that we can contact you regarding your response and for statistical purposes. We may also use it to contact you about related matters.

#### **3. Our legal basis for processing your personal data**

As a public authority, the GDPR makes provision for Ofgem to process personal data as necessary for the effective performance of a task carried out in the public interest. i.e., a consultation.

#### **4. With whom we will be sharing your personal data**

We will not be sharing your personal data with other organisations.

#### **5. For how long we will keep your personal data, or criteria used to determine the retention period.**

Your personal data will be held for up to twelve months after the consultation process closes.

#### **6. Your rights**

The data we are collecting is your personal data, and you have considerable say over what happens to it. You have the right to:

- know how we use your personal data
- access your personal data
- have personal data corrected if it is inaccurate or incomplete
- ask us to delete personal data when we no longer need it
- ask us to restrict how we process your data
- get your data from us and re-use it across other services

- object to certain ways we use your data
- be safeguarded against risks where decisions based on your data are taken entirely automatically
- tell us if we can share your information with 3<sup>rd</sup> parties.
- tell us your preferred frequency, content and format of our communications with you.
- to lodge a complaint with the independent Information Commissioner (ICO) if you think we are not handling your data fairly or in accordance with the law. You can contact the ICO at <https://ico.org.uk/>, or telephone 0303 123 1113.

**7. Your personal data will not be sent overseas**

**8. Your personal data will not be used for any automated decision making.**

**9. Your personal data will be stored in a secure government IT system.**

**10. More information** For more information on how Ofgem processes your data, click on the link to our "[ofgem privacy promise](#)".