



Scotia Gas Networks Limited

Consultation on Ofgem's minded to position for the determination of re-opener applications in respect of additional income associated with the Traffic Management Act (and Transport Scotland Act) under the first Gas Distribution Price Control Review

24th November 2011



1. **Executive Summary**

Scotia Gas Networks Ltd (SGN) welcomes the fact that Ofgem has recognised the additional costs imposed on Scotia Gas Networks as a result of the implementation of the Traffic Management Act (TMA), including the effects on productivity. We also welcome the fact that Ofgem recognises that these costs will increase as permit schemes are rolled out to the remaining Local Authorities and agree that a further timely review of these costs in the next PCR is a sensible way forward.

However, we do have concerns that Ofgem's approach to setting the allowance for the additional costs through benchmarking Local Authorities is inequitable. Taking the lower end of Local Authority costs fails to recognise the demographics of Local Authorities and the inconsistencies of implementation across Local Authorities. This approach penalises the GDN's that have already incurred a high level of additional costs, for reasons outside their control.

We do not agree with the reasons for Ofgem's decision that Scotland Gas Networks claim is below 1%, and still contend that Scotland Gas Networks has incurred significant additional costs above 1% trigger, as a result of the implementation of the Transport for Scotland Act (T(S)A). These costs have not been incorporated in the allowances set in GDPCR1.

We have commented in greater detail below.

1.1 **Scotland Network**

We do not believe that Scotland's claim has been considered fairly and judged equally with other GDN's, as Scotland cannot be benchmarked against other GDN's, due to the differences in the legislation. Consequently, we feel that the resultant decision is flawed and we are still of the opinion that Scotland has 'triggered' as a direct result of the Transport Scotland Act (T(S)A) legislation.

It is clear that the Scottish Road Works Commissioner (SRWC) has driven a significant step change in the way Scottish Road Authorities coordinate and control street works activities on the highway. The position of the SRWC was established under section 16 of the T(S)A, and is accountable to the Scottish Ministers and ultimately the Scottish Parliament. We maintain our position that the increase in costs that SGN has incurred is as a result of the implementation of the T(S)A and not NRSWA, and hence was not included when Ofgem set the allowances for GDPCR1.

We are also uncertain of the rationale used by Ofgem in dismissing the claims from Scotland, as there seem to be some inconsistencies within the consultation. We have deduced from Ofgem's response that an incorrect view has been taken that a proportion of the costs for Scotland relate to components of the T(S)A which were already enacted in NRSWA and that these were considered and allowed for in setting the efficient costs for all companies in GDPCR1. This is actually not the case and we would contend that the T(S)A has driven a significant increase in costs.

We would strongly recommend that Ofgem recognise these issues and reconsider their original decision.

1.2 **Southern Network**

The concerns we have with the proposed Southern settlement, are summarised below, and further detail is given later in our response.

1.2.1 **Fixed Penalty Notices (FPN)**

Ofgem have not included the FPNs issued from Local Authorities that are not operating a permit scheme. Under the TMA, there are seven reasons specified why a Local Authority can issue a FPN. Of these six were implemented¹ and are issued by all Local Authorities, irrespective of whether they operate a permit scheme. With the implementation of the Permitry Regulations, a further two FPN's have been introduced that relate to Permits.

All FPNs are TMA related, as the NRSWA legislation did not have any such scheme in place.

We also do not agree with the suggested average unit cost of a FPN (£80) which has been used in order to calculate an efficient value of FPNs. FPN's are £120 or £500 and can be discounted to £80 or £300 if paid within 29 days. We challenge all FPNs and we believe we incur an efficient level of FPNs. Ofgem should note that the unit cost incurred by SGN so far this year is £230.

We believe that we have reached our optimum level of efficiency with regard to the reduction of FPNs charges. However, currently not all Highway and Permit Authorities are charging all the FPNs the system allows them to.

This would reinstate £250k

1.2.2 **Productivity & Other Costs**

We welcome the fact the Ofgem has recognised that there has been a significant adverse impact on productivity as a result of the implementation of the TMA. However, we disagree with the proposed level of unit cost used to calculate this element of the settlement, and question why the lower end of the unit cost range was used. It would also be very difficult to ascertain absolute year on year cost efficiencies, as recommended in your consultation, as the Local Authorities that are currently relaxed in applying TMA start to become more stringent in applying the Act. We have already provided evidence of some Local Authorities within inner London, which are implementing TMA more stringently, and have unit costs of well above the benchmarked £18k. Based on actual costs we have incurred to date, our highest unit cost within this area is currently £40k. These are actual incremental costs incurred outside our control.

Ofgem should also note that SGN has very little scope in influencing how individual Local Authorities apply TMA. The application of TMA currently varies widely between Local Authorities and there is very little consistency. The way in which an authority chooses to manage their road network (some significantly more stringent than others), can have a major impact on the costs we incur, and this inconsistency in approach by the Local Authorities means that SGN's costs have increased by different amounts across Local Authorities. Therefore, you cannot benchmark across

¹ The seventh FPN relates to Lane Rental

the Local Authorities, as we have little control of efficiencies, and in fact the costs will tend to lean towards the higher end of the range, over time.

1.2.3 Ongoing Administration Costs

Ongoing Administration Costs include:

- Back office administration,
- Traffic Management Schemes,
- Traffic Management Plans,
- Management time,
- Training costs,
- IT costs,
- Presite surveys,
- Site meetings.

Ofgem have assumed a unit cost of £8k per project to cover these areas. During 2010/11, SGN were operating at a unit cost of just under £11k. Although, we will always endeavour to reduce costs, we do not believe that the £8k is a reasonable or justifiable unit cost for ongoing administration. We will always try to ensure that all expenditure is incurred as efficiently as possible but given that the Local Authorities apply TMA in an inconsistent way this is not possible. For SGN to manage these differing expectations it is necessary to ensure we have adequate resources in place which requires time and labour. Again, we believe that Ofgem has disregarded these external factors which affect efficiencies.

In addition we believe these costs will increase as more Local Authorities adopt permit schemes.

This would reinstate £1m

1.2.4 Conclusion

Southern's submission, excluding future additional costs for Local Authorities implementing permit schemes, totalled £28m, compared to the proposed settlement of £22m. Based on evidence put forward, in this response, we believe a large proportion of the shortfall should be reinstated.

Ofgem have stated in the consultation that all the costs are in 2010/11 prices. This was not the case for SGN. It was stated in our submission that the years 2008/09 & 2009/10 were in money of the day, and all other years were in 2010/11 prices. Ofgem would need to inflate these two years, to ensure consistency, before any decision can be made.

We welcome Ofgem's proposal on uncertain costs. However, we require further clarity from Ofgem on how they intend the mechanisms to work, the time period involved, and also how the recovery of these costs would operate, before we could be in full agreement with the recommendation.

The remainder of our response deals with the specific questions asked by Ofgem, and the above points are expanded further within this section of our response.

2. Specific Questions

Question 1: Do you agree with the proposed adjustments to the revenues associated with TMA for the three GDN's, North London, Southern and Scotland?

SGN agree that Ofgem have addressed the main issues in their proposed adjustments to the revenues associated with TMA, but disagree with Ofgem's methodology in arriving at these amounts, which it is believed inadequately compensates Southern and Scotland for costs already incurred and is likely to lead to further shortfalls against future costs.

SGN agree with Ofgem that it is very difficult to benchmark costs of Local Authorities that have yet to implement permit schemes, and in principle, accept Ofgem's recommendation on this area going forward, but we require further clarification on how Ofgem plan to do this.

Our concerns on how Ofgem have approached their proposed settlements are as follows:-

2.1 Fixed Penalty Notices (FPNs)

It has been stated in the consultation document that costs associated with FPNs has been excluded if the associated Local Authority were not operating a permit scheme. This should not be the case. TMA FPNs were enforced before the introduction of permit schemes. They were introduced on 12th May 2008, across all Highway Authorities (*please see Appendix A for extract of the relevant legislation*). All FPNs incurred are as a result of TMA, as NRSWA did not have any legislation covering FPNs.

The introduction of permit schemes in January 2010, added another two FPNs which are the failure to issue a permit, and failure to meet the conditions of a permit.

We would also challenge the use of £80 as an average unit cost per penalty average unit. The actual costs for FPNs are £120 or £500. An £120 FPN can become £80, if it is paid within 29 days, and a £500 FPN can become £300. Quite often SGN will dispute the FPNs that have been raised and manage to get them removed. However, this does not apply to all and consequently, a £80 FPN can become £120, and a £300 FPN can become £500. We manage these costs efficiently at present, which can be seen from the low volume of FPNs that we have paid, and will continue to manage these in this manner. However, the average unit cost actually paid during 2010/11 was nearer £230 per penalty, and not the £80 proposed by Ofgem.

In addition we dispute the use of permits as a driver for FPN costs as being appropriate. Only two out of the nine types of FPNs currently within the TMA legislation apply to permits. We would recommend using the number of projects, or notices as a more suitable driver for FPNs.

2.2 Productivity & Other Costs

TMA has had an adverse impact on productivity and has driven down the overall production rates of our teams and our contractor teams, especially within the replacement programme. We have no real influence with Local Authorities when they apply TMA. The working constraints, (e.g. restricted working hours, restricted lengths of road to be closed at any one time, directions to increase teams on site, carry out additional work on site etc.) that are put on SGN can and does vary from one Local Authority to another.

We will always endeavour to reduce unproductive costs, but in many occasions, factors affecting productive working are not wholly within SGN's control as the parameters affecting efficient management of works are dictated by the individual Local Authority permit schemes and directions with which we must comply. Ofgem have failed to recognise these external factors when setting the efficient unit cost for productivity.

We agree that the unit cost should be determined using the cost per km of main abandoned. However, we do not agree with the use of a unit cost of £18k.

The unit cost range stated in the document is between £18,7k and £44,7k. Ofgem have opted for an efficient unit cost of £18k for 2010/11 & before, reducing to £16k in 2012/13. We would question why Ofgem has used £18k, as by doing so they are clearly disadvantaging the Distribution Networks that are already at the higher end of the scale.

As can be seen from our submitted templates, the Local Authority we identified that operates a Permit Scheme (a London Borough) had an average unit cost of £30k. This unit cost is representative of Local Authorities that currently operate Permit Schemes within our geographic area. We are of the opinion, as more Local Authorities start to implement Permit Schemes that this level of unit cost will become standard across all Local Authorities. We currently have unit costs of £40k for work on the Transport for London (TFL) road network.

The Mayor of London is currently campaigning to significantly reduce the impact of road works, and the number that are undertaken. (Attached is a copy of the Mayor's letter, and also a copy of the London code of conduct (which is due to be revised), with which we have to adhere). The Mayor expects all Utilities and London Boroughs to sign up to these new codes of conduct. He is pushing all London Boroughs to become Permitting Authorities, and expects this to happen rapidly. He also states that there should always be a presence on site. We envisage that our Traffic Management Costs will escalate as a result of this, and cannot see how efficiencies will be made within the immediate future.

If Ofgem intend to use a unit cost approach, our actual range of unit costs, which are based on the real expenditure we have incurred, would be more appropriate.

2.3 Ongoing Administration Costs

The ability to manage ongoing administration costs is affected by the approach each Local Authority adopts for Traffic Management. The introduction of the Permitry Scheme has meant an increase in both the back office administration, and the management effort negotiating with Local Authorities. This will increase as the remaining Local Authorities start to implement the permitry scheme. The number of permitting authorities will rapidly increase now that the DfT is planning not to approve permitting schemes in the future.

As additional Local Authorities adopt permit schemes, a significant increase in resources will be required in order to absorb the additional administration burden this will bring. Traffic management administration is very labour-intensive and time-consuming. Again, we are always striving to maintain efficiencies within the organisation, but cannot effectively manage the inefficiencies of the individual Local Authorities, who wrongly issue FPNs, but which still have to be reviewed and rigorously investigated before rebuttal.

If Ofgem insist on going forward with an Ongoing Administration unit cost, there needs to be a mechanism for dealing with the escalation of administration costs as the number of permitting authorities increase.

2.4 Scotland Gas Networks

Prior to the implementation of both the TMA and the Transport (Scotland) Act (T(S)A), both Scotland and Southern Networks incurred street work costs under New Roads & Streetworks Act 1991 (NRSWA). SGN acknowledge that these costs would have been included in our allowances in the initial PCR submission and a portion of these costs are still relevant today. *(Please refer to Appendix B which highlights the NRSWA costs that both Scotland and England were incurring during the allowance process).*

In 2008 the Transport Scotland Act (T(S)A) legislation was implemented. This brought new changes, which were similar to the TMA (i.e. introduction of FPNs, noticing changes, Additional Section 115A – directions relating to placing of apparatus, increase in fines)

As these changes occurred during 2008/09 and were unknown at the time of our submission for GDPCR1, these additional costs were not taken into consideration when setting these allowances. *(Please refer to Appendix C for comparison of types of costs prior and after T(S)A)*

We contend that Scotland Gas Networks administration costs will significantly increase over the period of the current PCR and that this increase is solely associated with the implementation and management of T(S)A.

Underlying costs associated with administration of NRSWA sanctioned in our original allowance continue to be incurred at 2007/2008 level. Additional costs incurred have been as a direct result of additional resource having to be in place in order to comply with all of the above mentioned T(S)A changes. If we make the assumption that the level of the administration costs remain at 2007/08 level throughout this PCR period, we are still of the opinion that Scotland has triggered during 2010/11. *(Please refer to Appendix D, please treat as confidential)*

SGN would like to take this opportunity to reiterate that whilst Traffic Management in Scotland is not managed in the same way as other parts of the UK, the impacts are similar to the rest of the UK, and are detailed below.

- Instead of having permit schemes, enhancements have been made to the Scottish Road Works Register which has had a similar impact. As a consequence of this the Scottish Government decided that, Scotland did not require a permit scheme.
- The process for noticing SGN works significantly altered under T(S)A. Prior to implementation, notices were issued by project address and amendments to dates or details were managed on an ad hoc basis. After implementation of T(S)A, utilities are now obliged to notice works on a street by street basis, which is the same as TMA. This allows Road Authorities to issue an increased level of FPNs for failure to manage notices within specific timescales. As with our southern counterparts, all FPNs are reviewed and challenged, before finally being agreed upon
- The primary duty of coordinating road works before the implementation of T(S)A, was carried out by the Road Authorities. However, since the introduction of T(S)A, the responsibility falls to the Utility to self-coordinate their works. This has added an interactive, administrative element to the noticing process that cannot be automated.

These are all as a direct result of the implementation of T(S)A legislation, and not ongoing NRWSA legislation.

The consultation document claims that Scotland is less affected by losses in productivity. However experience shows that this is not to be the case and, once all Local Authorities fully adopt the additional traffic management directions afforded by T(S)A, the negative effect on productivity will escalate throughout the whole of Scotland.

2.5 Uncertain Costs

SGN welcomes Ofgem's proposal about uncertain costs that may impact us (e.g. Increases in S74 charges, lane rental and future Local Authorities implementing TMA). However, we would require further clarity on how this mechanism would work, and the timing and recovery of these additional costs, before we could give our full support to this.

We would like to take this opportunity to bring to your attention, the fact that the s74 overstay charges legislation has now been given the go ahead in Scotland, and we expect this to be implemented within the next two years. These costs will start to be incurred within this current price control.

Question 2: Do you agree with the proposed principles that have been set and that these should be applied to future TMA re-openers and price controls?

SGN support the proposed principles that Ofgem has identified, i.e. improved working with Local Authorities, reducing fixed penalties, more accurate noticing/permitting, and more efficient administration, and we are currently reviewing innovative methods to implement these. However, during the present uncertainty, within the street works environment, it will be extremely difficult to reach the savings proposed in the consultation, during the current price control.

Question 3: Do you agree with the timeframe within which it is proposed that additional revenues will be recovered?

SGN agrees with the proposed timeframe, in order to recover the additional revenues within the current price control period.

We also welcome Ofgem's agreement to look at the additional costs associated with changes/further implementation of legislation. Some of these costs are already starting to be incurred, and should be subject to a separate re-opener, within this price control.

APPENDIX A – FIXED PENALTY NOTICES

This chapter provides information about the Fixed Penalty Notice (FPN) scheme for street works.

The fixed penalty notice scheme is introduced by section 41 of the TMA, which inserted section 95A and schedules 4A and 4B into NRSWA. It provides for certain offences, under Part 3 of NRSWA, to become fixed penalty offences.

The objectives of the FPN system are to:

- encourage accurate and timely notice data
- improve the co-ordination of works
- improve data quality for all works promoters
- contribute to the aim of the TMA - minimising disruption arising from road and street works.

OFFENCE CODES AND DESCRIPTION		
(By reference to the New Roads and Street Works Act 1991)		
CODE	OFFENCE	BRIEF DESCRIPTION
01	An offence under section 54(5).	Failure to comply with duties under s.54 (advance notice of certain works, etc.)
02	An offence under section 55(5).	Beginning to execute works in contravention of s.55 (notice of starting date).
03	An offence under section 55(9).	Failure to give notice in accordance with s.55(8) (notice to be given on s.55 notice ceasing to have effect).
04	An offence under section 57(4).	Failure to give notice in accordance with s.57 (notice of emergency works).
05	An offence under section 70(6) consisting of a failure to comply with subsection (3) or (4A).	Failure to comply with requirements to give notice of completion of reinstatement.
06	An offence created by regulations made under section 74(7B).	Failure to give a notice required by regulations under s.74 (charge for occupation of the highway where works unreasonably delayed).
07	An offence created by regulations made under section 74A(11).	Failure to give a notice required by regulations under s.74A (charge determined by reference to duration of works).

APPENDIX B – Scotland vs. South NRWSA Costs

New Roads & Street Works Act (NRWSA) Costs	
Prior to TMA in England	Prior to TSA in Scotland
NRSWA Defect Charges	NRSWA Defect Charges
NRSWA Inspection Charges	NRSWA Inspection Charges
Low level of traffic management drawings (Hand prepared)	Low level of traffic management drawings (Hand prepared)
Low level of s56 power of directions notifications	Low level of s115 power of directions notifications
Less Admin resource on NRSWA duties	Less Admin resource on NRSWA duties
Managers didn't attend co-ordination meeting	Managers attending co-ordination meetings
Less inclined to attend SEHAUC/LHAUC meetings	Voluntary use of SRWR
Less Court prosecutions	
Low level of coring costs by Highway Authorities	
s74 charges	

The highlighted cells represent common costs within both Scotland & England

APPENDIX C – Costs incurred before and after T(S)A

Before T(S)A	After T(S)A
NRSWA Defect Charges	Appointment of Scottish Road Works Commissioner
NRSWA Inspection Charges	Fixed Penalty Notices
Low level of traffic management drawings (Hand prepared)	More stringent Noticing requirements & noticing on a street by street basis
Low level of s115 power of directions notifications	Mandatory use of the enhanced Scottish Road Works Register
Less Admin resource on NRSWA duties	Increased directions from Road Authorities
Managers attending co-ordination meetings	Mandatory attendance at working groups
Voluntary use of SRWR	
Blanket noticing	