

Network operators, consumer groups, energy suppliers, Department for Transport, Scottish Road Works Commissioner, Transport for London and any other interested parties.

Our Ref: SG&G/Costs & Outputs
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Dear Stakeholders

Notice of decision for the determination of an income adjusting event claim associated with the Traffic Management Act and the Transport (Scotland) Act under the first gas distribution price control review

We recently consulted on our minded-to position¹ with regard to the applications received for the income adjusting event (IAE) associated with the Traffic Management Act 2004 and the Transport (Scotland) Act 2005^{2,3}.

This letter sets out our decision for the adjustment to the gas distribution network operators' (GDNs) revenues and the timeframe over which this should be recovered.

Based on our analysis of the submissions and following consideration of the responses to our minded-to consultation, we have decided to maintain our position and will allow efficient additional costs for the TMA IAE of £0.4 million against £12.5 million claimed, as set out in Table 1.

We consider that overall the additional evidence provided by the GDNs in response to our consultation is insufficient to justify allowing any more than the efficient costs previously assessed in our minded-to position, with the exception of two areas within Scotland's claim. For Scotland, we have revised our assessment of efficient costs from £1.2 million to £1.4 million, but as this remains below the threshold of one per cent of its base revenues of £2.3 million required to trigger an IAE, no allowance will be made. For London and Southern the previous 2011 reopener applications triggered the threshold and hence they do not need to trigger again. Further detail on this is set out in the "Assessment approach"⁴ section of our minded-to consultation.

The recovery of costs will be treated as a legacy GDPCR1 item⁵ and recovered over the RIIO-GD1 price control period (2014-2021). The impact on customers' bills will be less than

¹ [Consultation on our minded-to position for the determination of an income adjusting event claim associated with the Traffic Management Act and the Transport \(Scotland\) Act under the first gas distribution price control review.](#)

² This act was passed to make provision in relation to the management of road networks; to make new provision for regulating the carrying out of works and other activities in the street; to amend Part 3 of the New Roads and Street Works Act 1991 and Parts 9 and 14 of the Highways Act 1980.

³ Traffic Management Act 2004 and the Transport (Scotland) Act 2005 are referred to throughout this document collectively as "TMA" unless the context requires otherwise

⁴ The "Assessment approach" section can be found on page 4 of our minded-to consultation. The link to this publication is in footnote 1

⁵ Modifications were made to several Special Conditions in gas transporter and the Price Control Financial Handbook - [Modification - Gas Transporter Special Conditions](#) of which part 8 refers to IAE cost adjustments relating to the legacy period (special condition 3A legacy price control adjustments).

half a pence for London and less than two pence for Southern per customer per year for the price control period.

Table 1: Cost impact - GDN TMA IAE claims and allowances⁶

GDN	TMA IAE claims and allowances		
2010-11 prices	Original Submission June 2013	Revised Submission Aug / Sept 2013	Ofgem allowances
SGN Scotland	£10.16m	£9.76m	zero
SGN Southern	£1.90m	£1.90m	£0.35m
NGG London	£1.76m	£0.88m	£0.07m
Total	£13.82m	£12.54m	£0.42m

Background

The previous gas distribution price control for 2008-2013 (GDPCR1) enabled the GDNs to apply to Ofgem to adjust their revenues to recover costs associated with the Traffic Management Act 2004 and the Transport (Scotland) Act 2005.

The Gas Transporters Standard Special Condition E7⁷ sets out a mechanism under which GDNs can apply for their allowed revenues to be adjusted through an IAE. Following consultation, the Authority⁸ determines whether the threshold has been reached to trigger the IAE (which only applies to Scotland⁹) and whether any or all of the costs or expenses were or are likely to be efficiently incurred and whether any adjustment should be made to their allowed revenue.

We previously consulted and made our decision¹⁰ on a TMA IAE in 2011 and as part of that process we gave the Licencees (ie holders of a gas transporters licence) an opportunity to make further claims at the end of GDPCR1 in line with the criteria set out in our decision paper (2011 Decision Paper).

Three GDNs, (Scotland Gas Networks plc (Scotland), Southern Gas Networks plc (Southern) (the two GDNs owned and operated by Scotia Gas Networks (SGN)), and National Grid Gas plc (NGG) for their London network (London)), gave Notice to the Authority of an IAE and proposed a relevant adjustment to their allowed revenue. After reviewing their submissions and following clarification meetings, two GDNs adjusted their claims.

Responses

We received five responses to our consultation. These were from SGN (covering both Scotland and Southern), NGG (for London), Transport for London (TfL), the Scottish Road Works Commissioner (SRWC) and one confidential response. With the exception of the confidential response, the responses have been published along with our decision.

Also, during the consultation period, SGN (Scotland and Southern) asked for clarification on where the additional information it provided during the review process fell short of our expectations, so it could address this as part of its response to our consultation.

⁶ The claims and allowances for this IAE are over and above those made in the 2011 TMA IAE reopener.

⁷ [Special Condition E7: Determination of any adjustment factor to be applied to MRt \(IAEt\)](#)

⁸ Authority means the Gas and Electricity Markets Authority that is established under section 1 of the Utilities Act 2000. In this consultation, references to the Authority are used interchangeably with references to Ofgem.

⁹ As explained in our consultation letter.

¹⁰ [Notice of decision for the re-opener applications in respect of additional income associated with the Traffic Management Act \(and Transport for Scotland Act\) under the first gas distribution price control review](#)

As part of Scotland's response it disagreed with a number of areas of our assessment, Southern disagreed with our assessment of lane rental and London disagreed with our assessment of lane rental and productivity. Further detail on the GDN's responses and our further assessment can be found in Appendices 1-3 to this letter.

TfL supported our proposal not to grant any allowances for lane rental, commenting that "The principles of the scheme would be completely undermined if utilities were able to simply pass on these avoidable costs to consumers".

The SRWC raised concerns over our assessed efficient costs for back office and administration. The Commissioner considers these costs to be in compliance with NRWSA¹¹ and not the T(S)A. For fixed penalty notices (FPNs), the Commissioner believes that GDNs' ability to recover costs undermines the objective of FPNs to change behaviour to minimise the impact of road works.

In addition, the SRWC commented on some of the detail in our consultant's report¹². We address each point raised by the SRWC in Appendix 1, having discussed them with our consultant. We are content that our minded-to position and final decision are not impacted by any of the issues raised by the SRWC.

The confidential response supported our minded-to position.

Our decision

We have considered the responses following our consultation and maintain our overall position to allow £0.4 million costs against the £12.5 million claimed.

We also considered the request from SGN during the consultation period and had a further meeting where we gave additional clarification and provided examples where we gave SGN opportunities to provide robust evidence during the assessment process. We are satisfied that throughout the review process the level of discussions were extensive and reasonable with all three GDNs.

Other stakeholders

In coming to our decision, we have considered responses from other stakeholders (ie other than the GDNs).

We agree with TfL that the lane rental scheme would be undermined if the costs were simply passed on to the customer. As part of any future uncertainty mechanism claims for streetworks which include lane rental, we will consider costs where GDNs demonstrate that it has implemented procedures that optimise the costs associated with any work in roads covered by a lane rental scheme.

We note the SRWC's point that certain back office administration and management costs are related to compliance under NRSWA, but consider additional burden is associated with the T(S)A and therefore made an allowance as a relevant IAE expenditure. This is consistent with our decision in our previous reopener in 2011 for Southern and London.

In respect of FPNs, we expect GDNs to target zero fixed penalties, but in doing so the costs and benefits of achieving this should be considered and whether it is cost efficient overall. In our previous re-opener in 2011, we set an efficiency rate of 3 per cent, however in this re-opener we have allowed Scotland only the efficient part of its claim which equates to approximately 0.5 per cent of FPNs/Notices issued.

¹¹ New Roads and Street Works Act 1991

¹² Les Guest Associates - this report was published as part of our minded-to consultation

Scotland

We increased our assessment of efficient expenditure for Scotland from £1.2 million to £1.4 million. However, in spite of the additional expenditure the efficient costs assessed remain below the threshold of one per cent of Scotland's base revenues of £2.3 million, and therefore an IAE has not been triggered and no allowances will be made, consistent with our minded-to position.

We reassessed and revised our position for temporary traffic regulation orders¹³ (TTROs) and reinstatement costs but for the other areas challenged we maintain our position that Scotland did not provide any further relevant evidence and therefore we do not allow these costs.

Further details of Scotland's response and our decision can be found in Appendix 1.

Southern

We are allowing Southern £0.4 million under the TMA reopener consistent with our minded to position.

Whilst Southern provided further information it was not relevant to support changing our position. We still cannot establish that a process existed and was implemented to minimise the overall cost impact within the lane rental scheme area.

Further details of Southern's response and our decision can be found in Appendix 2.

London

We are allowing London £0.07 million under the TMA reopener consistent with our minded to position.

Whilst London provided additional information for its lane rental claim, this was not relevant to support changing our position. London remains unable to demonstrate that it undertook the most efficient / optimal course of action to minimise the overall cost impact within the lane rental scheme area.

For productivity, £0.2 million relates to costs for London's consultants for data assurance which we consider is not a TMA related cost. This should be funded from the allowances given for GDPCR1. In respect of the remaining £0.1 million productivity claim, London has not provided further evidence. We maintain our position and do not allow this cost.

Further details of London's response and our decision can be found in Appendix 3.

This letter constitutes the notice for the purpose of section 38A of the Gas Act 1986.

Yours sincerely,



Paul Branston
Associate Partner, Costs and Outputs

¹³ Referred to in SGN's claim as temporary traffic restriction orders

Appendices

- 1. Appendix 1 – Detailed response and our decision - Scotland**
- 2. Appendix 2 – Detailed response and our decision – Southern**
- 3. Appendix 3 – Detailed response and our decision - London**

Appendix 1 – Detailed response and our decision - Scotland

In our minded-to consultation we proposed not to allow Scotland any of the additional costs it requested under the T(S)A reopener since our assessment of the efficient costs incurred was £1.2m, which is below the £2.3m threshold SGN needed to trigger the reopener.

Following our review of the responses to the consultation we have reassessed our minded-to position in two areas which increased our assessed efficient costs from £1.2 million to £1.4 million. However, this level of efficient costs remains below the threshold and therefore an IAE has not been triggered and no allowance will be made.

Scotland's response

Scotland disagreed with five specific areas of our assessment amounting to £2.5 million as follows:

- IT running costs (£0.2m)
- Traffic management schemes (TMS) (£1.5m)
- Timing and duration conditions (£0.6m)
- Temporary traffic regulation orders (£0.1m)
- Additional reinstatement costs (£0.2m)

Scotland provided further evidence to support its claim for traffic management schemes and timing and duration conditions.

Scotland did not contest contractor and related costs of £2.9 million, the Scottish Road Works Register (SRWR) costs of £0.5 million and the vac excavation costs of £0.7 million, which were disallowed in our assessment.

IT running costs

Scotland's response

Scotland confirmed that its claim relates to support staff who maintain new IT systems and enhanced infrastructure and excludes set-up costs and costs relating to Eton5 and consider it responded sufficiently to our supplementary questions (SQs) and enquiries raised during our visit to SGN in July 2013.

Our decision

We have reviewed Scotland's claim in light of its consultation response and note that the costs relate to support staff and not the implementation of new systems. The costs equate to approximately one FTE equivalent to maintain staff access to external websites and Clearman which enables input to the SRWR.

However, Scotland did not provide sufficient evidence to underpin this claim which we also consider to be excessive for the workload involved. We therefore maintain our minded-to position not to approve an allowance for IT costs.

Traffic management schemes (TMS)

Scotland's response

Scotland considered that the lack of evidence relates to the processes in place to illustrate the costs claimed and the evidence of increased FTEs. Scotland confirmed that incremental costs are collected through templates which it considers to be a sufficiently robust process, and provided a further sample of four templates as additional evidence.

Scotland confirmed it is unable to provide pre T(S)A costs as the same level of disaggregation was not required at that time. Scotland also referred us to its responses to our SQs issued during our assessment process.

Our decision

It is necessary to demonstrate the incremental costs of TMS expenditure associated with the T(S)A to support Scotland's claim. In order to achieve this and to support its claim, we requested evidence of pre-T(S)A costs and workload during our assessment process. We did not receive this information and we note from Scotland's consultation response that it is unable to provide this. We are unable to establish the overall efficient TMS costs and workload from the additional four templates or those previously submitted.

In the absence of a robust process and pre-T(S)A costs and workload we are unable to verify that the costs claimed are incremental, efficient and sufficiently accurate and we maintain our minded-to position not to approve an allowance for TMS costs.

Timing and duration conditions

Scotland's response

Scotland confirmed that much of its unproductive time cannot be easily mitigated and provided us with a summary of costs to demonstrate the process it has established to record this activity.

Scotland also highlighted that we, as well as our consultant, acknowledge that these costs are fundamental to the principles of the T(S)A and also referred us to its responses to SQs issued during our assessment process.

Our decision

Scotland did not provide additional relevant evidence to support and clarify its claim. We maintain that Scotland has not demonstrated how it has optimised unproductive time in its responses to SQs and we are still unable to determine efficient costs relating to the T(S)A.

In addition, the evidence provided to us with its response is inconsistent with previous supplementary evidence submitted during our assessment process in relation to the split of direct labour and contract labour.

We maintain our minded-to position not to approve an allowance for timing and duration condition costs.

Temporary traffic regulation orders (TTROs)

Scotland's response

Scotland refers to our consultant's report to support its claim, highlighting that the number of TTROs has increased in the past 5 years and that costs between 50 per cent and 100 per cent should be allowed.

Our decision

We have reassessed our position and recognise that in all likelihood there has been an increase in TTROs. We now support the view of our consultant and will allow 50 per cent of the costs claimed for TTROs.

Additional reinstatement costs

Scotland's response

Scotland informed us that the drive behind the increased reinstatement costs is due to changes in several road works Codes to incorporate the original intentions of the T(S)A for reinstatement which was not properly embedded in the T(S)A due to an error in the wording. Scotland's streetworks manager was closely involved in re-writing these Codes.

Our decision

We have reassessed our position and agree that these costs can be considered as being associated with the implementation of T(S)A. Whilst allowing the full amount claimed of £0.2 million, for any future claims we would expect further justification of efficient costs.

Contractors and other related costs

Scotland's response

Scotland stated that it will not contest our position further if we feel there is insufficient evidence to support its claim.

Our decision

We maintain our minded-to position and do not approve an allowance for contractor and other related costs.

Response from the SRWC

In the SRWC response the Commissioner commented on some of the detail of our consultant's report. We have discussed the Commissioner's response with our consultant.

The SRWC does not consider that the Commissioner has worked with our consultant, but recognises that the Commissioner has met and spoke with our consultant on more than one occasion. Our consultant confirmed this and stated that most of his dealings with the SRWC had been with the previous Commissioner.

The SRWC highlighted that the contribution from utilities to keep the SRWR is 65 per cent and not 70 per cent as stated in our consultant's report. Our consultant accepts this.

The SRWC believes there is confusion over the use of Eton5 in Scotland. Both Scotland and our consultant agree that Eton5 is not used in Scotland. Scotland also confirmed in its response that no costs were claimed for this.

The SRWC highlighted that the validity period for reinstatement did not result from legislation but arose from a voluntary agreement through the Roads Authorities and Utilities Committee (Scotland). Our consultant agrees with this.

The SRWC disputes the comment in the consultant's report that the Commissioner has encouraged authorities to demand more TTROs. The consultant was quoting from Scotland's claim when writing this. This was the view of Scotland in its submission.

We are content that our minded-to position and final decision is not impacted by any of the issues raised by the SRWC.

Appendix 2 – Detailed response and our decision - Southern

In our minded-to consultation we proposed to allow Southern £0.4 million for Section 74 overstay charges¹⁴, back office administration and permits. Following our review of the responses to the consultation we maintain this position.

Southern disagreed with our minded-to position for lane rental and believes that it provided sufficient evidence in both its claims and in responses to several SQs issued during our assessment process. Southern's response is focused on unplanned work which it considers is difficult to delay or alter and to support its claim provided a copy of the TfL's Scheme Monitoring Report.

Southern did not provide additional relevant evidence in its response and we therefore maintain our minded-to position to allow £0.4 million against its claim of £1.9 million.

Lane Rental

Southern's response

Southern's claim for lane rental is made up of £0.4 million charges and £0.4 million associated costs for team restructuring to focus on lane rental activity. In our consultation, we disallowed the total claim of £0.8 million, however, in its response Southern is only challenging £0.4 million relating to the disallowed lane rental charges.

Southern acknowledges that our concern lies in it having not demonstrated that it has minimised the financial effect of lane rental activity. Southern makes reference to new lane rental activities and processes implemented at its depots and refer us to its previous responses to our SQs.

Southern confirms that all its charges claimed and incurred are for unplanned work only, which it states is difficult to delay or alter. Southern used the TfL Scheme Monitoring Report to show that unplanned work has remained at the same level as during previous years as this very often cannot be deferred due to public safety.

Our decision

Southern did not demonstrate that it had processes in place to help decide on the optimal course of action and we therefore maintain our minded-to position to not allow costs for this claim. We consider that irrespective of whether the work is planned or unplanned, Southern should be able to demonstrate that an optimal action was taken. We do not believe that unplanned work cannot be delayed or altered beyond the initial 24 hour period where there is no charge. From the evidence provided, we cannot determine that efficient costs were incurred.

Future re-openers must include evidence to demonstrate how Southern has followed the optimal solution in avoiding the TfL charge. We would consider allowing costs where GDNs demonstrate that it has implemented and are operating practices that optimise the costs associated with planned and unplanned work in roads within a lane rental zone.

¹⁴ Overstay charges Section 74 NRSWA - charges for unreasonably prolonged occupation of the highway – changes implemented October 2012

Appendix 3 – Detailed response and our decision – London

In our minded-to consultation we proposed to allow London £0.07 million for Section 74 overstay charges. Following our review of the responses to the consultation we maintain our position.

London challenged our minded-to position for lane rental and productivity. London responded to our statement on errors and data inconsistencies highlighting that there was an error in its claim to the value of £8000 or less than 1 per cent of its revised claim.

London did not provide additional relevant evidence in its response and we therefore maintain our minded-to position to allow £0.07 million against its claim of £0.9 million.

Lane Rental

London's submission

London believes its lane rental claim to be at an efficient level and further supports this in its response to our consultation. In London's response it has reduced its lane rental claim from £0.5 million to £0.2 million. London also made reference to the TfL Scheme Monitoring Report which it considers to be "independent corroborating evidence on the success of cost avoidance". London does not agree that we made it clear that the "efficient / optimal course of action" needs to be demonstrated and believes it is unreasonable of us to disallow its actual incurred costs.

London described four main avoidance methods it used to reduce occupation in the highway, which are:

- **Restricted works to footway** – action taken to avoid encroachment into the highway;
- **Exempt works** – working outside the lane rental zone by using designated areas such as parking bays and bus stops;
- **Out of hours** – works undertaken outside the designated lane rental times; and
- **Innovation & collaboration** – deployment of innovative techniques to minimise job duration and use outside the lane rental periods. Working collaboratively with other works promoters or the highway authority to reduce charges to NGG.

London disagreed that its incurred costs should be disallowed and asked that we reconsider its reduced claim of £0.2 million.

Our decision

London did not provide additional relevant evidence and we therefore maintain our minded-to position to allow costs of £0.07 million.

London has not been able to clearly demonstrate that the most efficient / optimal course of action was taken to avoid lane rental costs. GDNs have been aware of the impending implementation of lane rental and this was claimed in its 2011 re-opener application. We believe it is reasonable to expect GDNs to have processes in place to manage the impact following the implementation of the lane rental scheme to incur an efficient level of cost.

London did not present a clear picture of days/jobs where a TLRS charge would have been incurred if it failed to actively avoid works within the lane rental boundary. We note that London has included within its evidence days/jobs where an embargo was in place or a charge would otherwise have been waived such as during preparation for the Olympics, which is not relevant.

The four avoidance methods described at least partly represent normal working practices driven by cost optimisation and operational safety. We believe these methods are considered for all streetworks activities including those outside the lane rental zone.

Productivity

London's response

London considers that it provided evidence in line with the criteria set out in our 2011 decision document and believes it provided the productivity impact for each year of the GDPCR1 period as well as submitting additional data to support its claim. London also points out that its unit costs for 2011-12 were benchmarked by us as part of the RIIO-GD1 price control.

Our decision

London's claim includes £0.2 million costs for consultants / data assurance, which we consider is not a TMA related cost and believe this should be funded from the allowances given for GDPCR1. In respect of the remaining £0.1 million, London did not provide further relevant evidence and again we maintain our minded-to position and do not allow this cost.

We could not see the relevance of the reference to the benchmarking of costs as part of RIIO-GD1 as the unit costs in London's IAE submission were not presented in a consistent way for us to make any comparison or to be able to reconcile them.

Other

London commented that there was an error in its claim to the value of £8000 or less than 1 per cent of its revised claim.

We maintain our position that London's claim contained a number of errors and data inconsistencies which we discussed with them during our assessment process.