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Our Ref: Gas Networks
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Date: 31 July 2015

Dear Stakeholder,

Consultation on our minded-to position for the determination of a proposed relevant adjustment associated with specified streetworks costs under the RIIO-GD1 price control review

We are seeking your views on our minded-to position in respect of National Grid Gas plc's (NGGD) proposed adjustment in relation to specified streetworks costs for the RIIO-GD1 price control period 2013-2021. The proposed adjustment was submitted under NGGD's Gas Transporter Licence, Special Condition 3F - Arrangements for the recovery of uncertain costs.

We would especially welcome responses to the specific question which has been set out below:

Do you agree with our assessment and our proposed relevant adjustments associated with specified streetworks costs, including lane rental, for NGGD's three gas distribution networks, East of England, London and North West?

The deadline for response is 1 September 2015 and it should be sent to Mick Watson (mick.watson@ofgem.gov.uk).

We will consider any response as part of our final determination which we will publish by the end of September 2015.

Our minded-to position

Subject to consideration of consultation responses, we are minded to propose efficient costs of £22.8 million and an overall proposed adjustment of £19.6 million against NGGD's application of £33.3 million.

Detailed analysis setting out our minded-to position can be found in Appendices 1 to 3.

Introduction

The RIIO-GD1 price control for 2013-2021 allows the gas distribution network companies (GDNs) to apply to the Authority[1], by means of a reopener mechanism, to adjust their allowed expenditure to accommodate specified streetworks costs.

[1] 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 and to the regulator.

Streetworks costs are costs incurred or likely to be incurred by GDNs in complying with their obligations under the Traffic Management Act 2004 (TMA)[2] when working in the highway.

At the time of setting allowed expenditure for RIIO-GD1, there was uncertainty around streetwork costs where Highway Authorities (HAs) had not introduced permit schemes prior to the start of RIIO. We therefore put in place an uncertainty mechanism under Licence condition 3F, to allow companies to apply to recover additional efficient specified streetworks costs, where the amount exceeds or is likely to exceed one per cent of the relevant GDNs materiality threshold (or a three per cent threshold for combined applications under more than one cost category with a minimum 0.5 per cent for each category)[3].

The GDNs may apply for relevant adjustments to their allowed expenditure during two defined reopener windows, May 2015 and May 2018.

NGGD made more than one application under licence condition 3F, therefore we have assessed their applications accordingly, and this consultation should be considered alongside our associated consultation on Enhanced Physical Site Security, which influences the outcome of this reopener.

Three of NGGD's GDNs, East of England, London and North West, have given Notice to the Authority and have proposed relevant adjustments to their allowed expenditure as set out in Table 1.

Based on our analysis of the applications we are minded to propose efficient costs for the three GDNs of £22.8 million as set out in Table 1. However, the efficient costs proposed for East of England fall below the one per cent materiality threshold trigger. We also considered East of England's combined applications for specified streetworks costs and enhanced physical security costs. East of England did not exceed the required the materiality threshold amount under the combined applications. We do not therefore propose to allow any costs for this GDN. The justified relevant adjustment for London and North West is £19.6 million as set out in Table 1.

Table 1: Cost impact – GDNs' and Ofgem's proposed adjustments

GDN *2014/15 prices*	Materiality threshold 1% trigger	GDN's submitted costs	Ofgem's view of efficient costs	Proposed adjustment to expenditure
East of England	£6.0 m	£10.0 m	£3.2 m	zero
London	£4.2 m	£14.3 m	£12.7 m	£12.7 m
North West	£4.3 m	£9.0 m	£6.9 m	£6.9 m
Total	**£14.5 m**	**£33.3 m**	**£22.8 m**	**£19.6 m**

Based on our proposed adjustment the average annual impact on customer bills over the remaining five years of the RIIO-GD1 period for each GDN is set out on Table 2. Further details on revenue and customer bill impact are set out in Appendix 4.

[2] TMA covers England and Wales. Scotland is covered under the Transport (Scotland) Act 2005

[3]Applications under licence condition 3F (paragraph 1A.7(a)) for relevant adjustments to its allowed expenditure for a single cost category are subject to a one per cent materiality threshold. However, where a GDN makes applications under licence condition 3F (paragraph 1A.7(b)) for more than one uncertain cost category, the combined materiality threshold of three per cent comes into effect. This means the amount of change to allowed expenditure aggregated across the multiple categories should exceed the three per cent threshold. In order for individual elements to be considered as part of the three per cent materiality they must also each exceed 0.5 per cent of the materiality threshold amount

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Table 2: Customer bill average annual impact 2016-2021 – GDNs' and Ofgem's proposed adjustments

Customer bill impact - annual average 2016-2021 *2014/15 prices*	Impact based on GDN's submitted costs	Impact based on Ofgem's proposed relevant adjustment
East of England	£ 0.27	zero
London	£ 0.60	£ 0.54
North West	£ 0.34	£ 0.26

Background - Streetworks

RIIO-GD1 is the first price control period[4] for GDNs under the new RIIO model, covering the period 2013-2021. As part of setting allowances for RIIO-GD1, we allowed efficient streetworks costs where Highway Authorities (HAs) had already implemented a permit scheme prior to the start of RIIO-GD1. The HAs included in our RIIO assessment were mainly within London[5] only and therefore affected only three of the eight GDNs, resulting in allowed expenditure for NGGD's East of England and London Networks and Scotia Gas Network's Southern network.

At the time of setting allowances, there was uncertainty as to which HAs would implement traffic management permit schemes in the future, the impact it would have on GDNs' activities and how they would operate in the highway. Therefore we put in place an uncertainty mechanism to allow companies to apply to recover additional efficient specified streetworks costs where new HAs introduced permit schemes or operated a lane rental scheme.[6]

We carried out similar assessments of streetworks costs during the previous gas distribution price control, GDPCR1, where we made two decisions on streetworks reopener applications.[7]

Scope of our assessment

The main categories of streetworks costs are outlined in Special Condition 3F and detailed in Appendix 5, however, the key areas included in NGGD's application are:

- Permit costs;
- Administration costs;
- Productivity (where this is impacted by the restrictions imposed by the HAs); and
- Lane rental

We assessed the claims based on the evidence provided by NGGD for each GDN. We also appointed a consultant, Les Guest Associates to review the applications and provide an independent view of the proposed adjustments. A link to this report can be found in Appendix 6.

[4] RIIO-GD1: Final Proposals - Supporting document - Cost efficiency and RIIO-GD1: Final Proposals - Finance and uncertainty supporting document
[5] The exception was the Kent permit scheme.
[6] Lane Rental Section 74A of the New Roads and Street Works Act 1991 – defined as "charge determined by reference to duration of works"
[7] GDPCR1 second TMA reopener December 2013 and GDPCR1 first TMA reopener - December 2011

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To enable us to assess the impact of lane rental costs, we required robust evidence of processes in place to help GDNs demonstrate where it is more efficient to incur the lane rental charge or manage their streetworks to minimise or avoid the lane rental charge.

Review of GDN applications and supporting evidence

As part of this consultation, we are publishing the GDNs' submissions[8]. Links to these reports can be found in Appendix 7.

We considered the consultant's assessment along with our own analysis to inform our view of the GDNs' submissions.

General overview

The GDNs are incentivised through the price control to improve operational performance. The incentives include:

- Delivering outputs more efficiently through the total expenditure (totex) incentive, where GDNs retain around 63 per cent of any totex outperformance.
- Innovation – through both the network innovation competition and allowance.
- Stakeholder engagement – GDNs can be financially rewarded for good stakeholder engagement.
- Customer service – GDNs can be financially rewarded for how they deal with customers when their supplies are interrupted or a new connection is made. They can also be penalised for their performance in the number and how they manage complaints.
- The discretionary reward scheme recognises where companies perform well in areas of environmental and social obligations.

In their reopener application covering the whole of RIIO-GD1, NGGD used 2013-14 actual data and forecast workload (as reported in their 2013-14 Regulatory Reporting Packs (RRPs)) to extrapolate the number of permits and the length of mains decommissioned impacted by permit schemes for the remaining years of RIIO-GD1 (2015-2021) to derive forecast costs.

NGGD has made little reference to the benefits of innovation in relation to streetworks in its three applications. NGGD has previously referred to the benefits of innovation in other publications such as its 2013-14 annual report commentary and in its recent Discretionary Reward Scheme (DRS) submission[9]. NGGD has referred to maximising the use and benefits of innovation and in its recent DRS submission it discussed the tangible benefits of innovation such as reducing the amount of excavation by using core and vac[10] for repairs; using CISBOT[11] to reduce the number of excavations; trialling PRISM[12] which may reduce a job from one week to one day.

We therefore would have expected NGGD to include the impact and benefits of innovation when forecasting streetworks costs for each GDN.

Whilst we recognise that additional costs will be incurred for streetworks we also consider that GDNs should strive to become more efficient and exploit innovation. We have therefore

[8] NGGD has requested that their claims be redacted in parts as they consider that the claims contain confidential and commercially sensitive material.
[9] The gas discretionary reward scheme under RIIO-GD1, aims to reward the performance of GDNs which best serve the interest of customers through initiatives over and above what GDNs have been funded for within RIIO-GD1.
[10] Coring and vacuum extraction technique allows companies to open the road, repair the pipes and reinstate the site faster than conventional excavation methods.
[11] CISBOT allows companies to fix joints on large scale iron gas mains without the need for multiple excavations
[12] PRISM technology to remedy problems associated with traditional ways of replacing gas mains; it will allow pipes to be replaced through just two excavations

included a three per cent annual cumulative reduction, starting in 2015,[13] on all cost categories to reflect efficiencies and the benefits of innovation, in addition to other specific adjustments made in each category for each GDN.

We also have concerns over the use of only one year's actual data as a basis for future costs and may update our proposed determination when we have considered the 2014-15 GDN reported data due at the end of July.

Prior to submission, we requested that the applications for relevant adjusted costs are forecast by HA, in line with previous streetworks reopeners. This is an important consideration as a number of GDNs highlighted differences between HAs as a significant issue for them to manage. However, NGGD did not submit its proposed adjustment on this basis and said that the information was not available at this level of detail.

The format for each GDN's claim covered three main areas: permit fees, administration costs and productivity costs with a dedicated section on lane rental for London.

A detailed analysis of our efficient review for each area can be found in Appendices 1-3. A brief overview of each area is outlined below.

Permit fees

Permit fees are driven by the number of permits submitted by GDNs and comprise permits granted and permit variations. Permit variations relate to changing circumstances for either the GDN or the HA, for example, a GDN may require an extension to an agreed duration or a HA may require a variation due to circumstances beyond its control.

Costs for permits depend on road category and streetworks activity, and fees charged by HAs can range from £40-£240 per permit and £35-£45 for permit variations. However, for variations initiated by a HA no fee is payable by the GDN.

We found the unit costs for all three GDNs to be reasonable, ranging from £44 per permit in the North West, £55 per permit in East of England and £71 per permit in London.

However, we found that the volume of permit variations was high across all three NGGD's GDNs, particularly in the North West, and therefore applied a ratio of 75:25 for permits granted to permit variations, based on an average ratio across other GDNs. This resulted in a proposed reduction to the forecast permit volumes and costs across all three GDNs. We expect all GDNs to work closely with HAs to avoid and minimise permit variations.

Our consultant concluded that permit fees are proportionate to the work types and schemes, however there is insufficient supporting evidence to substantiate that the level of permit variations have been efficiently incurred and that the volume of variations in North West is exceptionally high.

Administration costs

It is recognised that there is an administrative cost arising from the introduction of permit schemes. When we set RIIO-GD1 we based this on the number of projects carried out by the GDNs.

There was a large variation in unit costs per project across the three GDNs, which ranged from £207 in the North West, £480 in London and £2,169 in East of England. NGGD did not adequately explain or justify the differences across the GDNs, therefore we applied

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[13] Our proposed three per cent annual cumulative reduction starting in 2015, is an average derived from our assumptions for efficiencies and impact of innovation. For efficiencies we assumed an annual 0.8 per cent reduction in line with our RIIO-GD1 final proposals; for innovation we assumed 0.7 per cent starting in 2015 and increasing by 0.5 per cent each year.

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London's unit cost[14] to East of England, reducing East of England's proposed adjustment by £1.2 million. We accepted the unit costs for the other two GDNs.

Our consultant reviewed administration costs at the lower level activity and concluded that there is a lack of evidence and clarity for some cost categories although overall costs appeared to be reasonable.

Productivity

The GDNs must comply with the various TMA conditions in place such as timing and duration and road space and manage the potential impact these may have on productivity and working within the highway. When we set RIIO-GD1 we recognised that there was an impact on GDNs in how they operated within the highway. In setting the allowed expenditure we considered the length of mains decommissioned to be the appropriate driver.

There was a large variation in the cost per metre across the three GDNs for the length of mains decommissioned in areas impacted by the TMA, which ranged from £3.06 in North West, £4.86 in London and £25.94 in East of England. East of England explained that the reason for higher costs in its network is largely due to the impact of the East of England Permit Scheme (EEPS), one of the various schemes that operate within their network. However, as NGGD were unable to submit their application at a detailed highway authority level we were unable to make a judgement on whether these costs were efficient or justified. We therefore applied London's unit cost to East of England, reducing East of England's proposed adjustment by £4.7 million.

Our consultant concluded that productivity costs are understandable but it is unclear whether the costs are a mathematical exercise multiplying the impact for all works, or whether the costs recorded, are additional costs incurred. In addition some of the costs may be mitigated in the future by innovative techniques.

Lane rental

Lane rental applies to the London network application only.

Transport for London (TfL) introduced the TfL Lane Rental Scheme (TLRS) in June 2012 and therefore due to uncertainty was excluded when setting allowed expenditure for RIIO-GD1.

TLRS applies to 57% of TfL's road network and was designed to control the carrying out of specific works in specified traffic sensitive locations by applying a daily charge for each day that the street is occupied by the works. The daily charge will be dis-applied or reduced if the works take place outside traffic sensitive hours. The scheme therefore provides an incentive mechanism to change behaviour and minimise occupation of the street at traffic-sensitive times at the most traffic-sensitive locations.

We therefore expect GDNs to demonstrate evidence of processes in place for deciding on the most efficient/optimal course of action to minimise lane rental charges as part of this application.

After assessing the application, we recognise the work done by NGGD to better manage its lane rental process and costs for lane rental charges in London.

Our consultant concluded that the evidence provided for lane rental is comprehensive and that NGGD have mitigated the potential cost of fees. However, the planned introduction of innovative techniques will reduce the duration of works further, and hence will reduce lane rental fees for works that can only take place during the prescribed times.

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[14] In NGGD's application the highway authorities (excluding lane rental) included within their claim for their London network sit outside of the M25 motorway.

However, we consider the opportunity for efficiencies and innovation to better deliver streetworks in its network also apply to lane rental costs and have therefore also included the three per cent adjustment applied to all other streetworks costs.

Future reopener window

For the 2018 reopener window we only expect applications to be made where additional HAs have introduced permit or lane rental schemes.

Price Base

All financial values are stated in 2014-15 price base.

Responses and consent to share information

Responses to this consultation should be received by **1 September 2015** and sent to:

Mick Watson
Head of Gas Distribution
Smarter Grids and Governance
Ofgem
9 Millbank
London, SW1P 3GE

Tel: 020 7901 7416

Email: mick.watson@ofgem.gov.uk

Unless clearly marked confidential, all responses will be published by placing them in Ofgem's library and on its website www.ofgem.gov.uk. Respondents may request that their response, or part of response, is kept confidential and those who wish to do so should clearly mark their documents to that effect and include reasons for confidentiality. Ofgem shall respect this request, subject to any obligation to disclose information, for example, under the Freedom of Information Act 2000 or the Environmental Information Regulations 2004. It would be helpful if responses could be submitted electronically and/or in writing.

Yours faithfully,

Paul Branston
Associate Partner, Gas Networks

Appendices

1. **Appendix 1 – Detailed analysis of East of England's claim**
2. **Appendix 2 – Detailed analysis of London's claim**
3. **Appendix 3 – Detailed analysis of North West's claim**
4. **Appendix 4 – Financial mechanisms for price control variable value re-openers**
5. **Appendix 5 – Extract from Special Condition 3F. Arrangements for the recovery of uncertain costs – definition of 'specified streetworks costs'**
6. **Appendix 6 – Consultant 's Report – Les Guest Associates**
7. **Appendix 7 – GDN Submissions**

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Appendix 1 – Detailed analysis of East of England's claim

This appendix sets out the detailed analysis of the proposed adjustments against East of England's application and the rationale behind this.

East of England submitted a proposed relevant adjustment for £10 million, of which 59 per cent relates to costs associated with productivity. After assessing East of England's application and based on the evidence provided, we are minded to allow efficient costs of £3.2 million, however, as this falls below East of England's one per cent materiality threshold of £6 million, we are minded to not allow a relevant adjustment for specified streetworks costs.

We also considered East of England's combined applications for specified streetworks costs and enhanced physical security costs. East of England did not exceed the required materiality threshold amount under the combined applications, therefore we are minded to not allow a relevant adjustment under the combined applications for East of England. Details of costs claimed and proposed are set out in Table A1.1 below.

Overall, we found that in some areas there is not sufficient evidence to support East of England's claim. East of England's claim is based on an extrapolation of its 2013-2014 actual costs and forecast workload as reported in the 2013-14 RRPs. We have concerns over the use of only one year's actual data as a basis for future costs and we may update our proposed determination when we receive the 2014-15 actual reported data due at the end of July.

In addition, when considering future costs and workloads, East of England did not take into consideration any efficiencies or impact of innovation. NGGD has previously referred to the benefits of innovation in other publications such as its 2013-14 annual report commentary and in its recent DRS submission. NGGD have referred to maximising the use and benefits of innovation and in its recent DRS submission it discussed the tangible benefits of innovation such as reducing the amount of excavations by using core and vac; using CISBOT to reduce the number of excavations; trialling PRISM which may reduce a job from one week to one day.

In addition to adjustments made to specific cost categories of East of England's claim we have also applied a three per cent annual cumulative reduction to reflect efficiencies and impact of innovation across all cost categories starting from 2015.

Table A1.1 – East of England's proposed relevant adjustment application and Ofgem's proposed adjustment

East of England *2014/15 prices*	GDN's proposed adjustment	Ofgem's proposed adjustment
Permit fees	£2.5 m	£1.9 m
Administration costs	£1.6 m	£0.3 m
Productivity	£5.9 m	£1.0 m
Total	**£10.0 m**	**£3.2 m**

The key areas under review for East of England are permit fees, administration costs and productivity cost impacts.

Permit fees

The total costs claimed under this category are £2.5 million and we are minded to allow efficient costs of £1.9 million.

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East of England's submission

East of England claim that costs are higher in its region compared to all other GDNs due to the permit schemes in operation attracting higher charges due to the types of road the schemes apply to. In addition, East of England state that there are also differences between the HAs within its region in terms of charges and road types.

East of England state that they have taken into account permit scheme coverage and associated workload when calculating costs incurred and forecast costs.

East of England's claim for permit fees, both costs and number of permits, is based on the 2014 actual cost and workload data and extrapolated for future years. The number of permits is calculated by reference to the movement in mains replacement workload, repairs workload and the number of HA operators. The costs are then derived by applying the 2014 unit cost against the forecast workload.

Our minded-to position

East of England's claim shows an average cost per permit of £55 in 2014 which we consider reasonable.

The overall number of permits in 2014 are 5014, made up of permits granted (3159 and 63%) and permit variations (1855 and 37%). East of England did not provide any evidence to explain or support the number of permit variations reported. We appreciate that variations may be requested by HAs but we also consider there is an opportunity for GDNs to be more efficient.

We are minded to reduce the number of variation permits to reflect the opportunities for efficiencies in GDN behaviour and planning. We are therefore minded to reduce the level of variations to 25% for each year claimed including 2014, consistent with other GDNs.

We have also applied a three per cent annual cumulative reduction to reflect efficiencies and the impact of innovation.

Therefore, based on a cost per permit of £55, a reduced number of permits and including the three per cent annual cumulative reduction, we are minded to allow East of England proposed costs of £1.9 million.

Administration costs

The total costs claimed under this category are £1.6 million and we are minded to allow efficient costs of £0.3 million.

East of England's submission

East of England's claim includes costs for back-office administration, traffic management plans and site meetings. East of England state that its administration costs result in a unit cost per project of £2,169 and compare this against the unit cost of £8,000 per project set for the GDPCR1 reopeners and RIIO-GD1 allowances. East of England states that there is an increased need for onsite meetings and additional traffic management plans due to the types of roads and traffic sensitivity in its region which increases the cost per project. East of England comment that the same contractor operates in both the East of England network and London network and manages to the requirements of the individual HAs.

Our minded-to position

East of England has not provided sufficient evidence to support its claim for administration costs. The unit cost of £8000 quoted by East of England, was specific to streetworks within

London when it was set during the previous price control and for RIIO-GD1. We made it clear that this should not be used as a benchmark for the cost of streetworks outside London. East of England did not compare its unit cost of £2,169 to London's unit cost of £480 in its current application[15] and North West's unit cost of £207 and has not sufficiently explained why there are such variations across the three GDNs, particularly in London where the same contractor is used.

We are therefore minded to allow East of England a unit cost of £480 per project in line with the application for NGGD's London network for the first year, and we will also apply a three per cent annual cumulative reduction to reflect efficiencies and impact of innovation from 2015.

Productivity costs

The total costs claimed under this category are £5.9 million and we are minded to allow efficient costs of £1.0 million.

East of England's submission

East of England's claim for productivity equates to a unit cost per metre of mains decommissioned of £25.94 for each year over the eight year period. This cost applies to circa 25% of the length due to the EEPS scheme applying to major roads and traffic sensitive roads.

East of England also claimed that increased costs in productivity were primarily driven through the imposition of restrictive conditions placed upon them by the permitting authorities. The greatest impact for East of England is the 'Timing and duration' condition which can limit the time to undertake works on the highway, followed by the 'Road space' condition which limits the working zone reducing efficiency of the teams.

East of England compared unit costs for productivity of other GDNs including SGN's Southern network which for new HAs range from less than one pound per metre (SGN Southern Network) up to £25.94 per metre for East of England, whilst London and North West are £4.86 and £3.06 per metre respectively.

The forecast costs are extrapolated from the 2013-14 actual data and based on the forecasted mains replacement workloads within TMA areas, which is proportional to East of England's annual mains replacement forecast workload.

Our minded-to position

There is a lack of robust evidence to support East of England's claim of £5.9 million, which represents 57% of its total claim.

East of England has not provided sufficient evidence to quantify and validate its proposed unit cost of £25.94 and sufficient evidence to support its claim that costs are higher in its region compared to all other GDNs. East of England have also not provided any evidence to compare the costs of the HAs within its region. East of England claim that costs differ between the East of England Permit Scheme (EEPS), the Yorkshire Permit Scheme (YPS) and other HAs, but it did not provide any supporting evidence to show this in practice.

East of England has not considered efficiencies or the impact of innovation in its claim. East of England submitted a detailed analysis of the conditions it is impacted by for 2014, to support costs associated with productivity, but it has not demonstrated that these costs

[15] In NGGD's application the highway authorities (excluding lane rental) included within their claim for their London network sit outside of the M25 motorway.

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and activities are efficient and no consideration has been given to efficiencies or the impact of innovation in its forecast for future years.

In addition to the reduced unit cost to £4.86 per metre, we have also applied a three per cent annual cumulative reduction to East of England's proposed productivity for efficiencies and impact of innovation starting from 2015.

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Appendix 2 – Detailed analysis of London's claim

This appendix sets out the detailed analysis of the proposed adjustments against London's application and the rationale behind this.

London submitted a claim for £14.3 million, of which 40 per cent relates to lane rental and 38 per cent to productivity related costs. After assessing London's application and based on the evidence provided, we are minded to allow an efficient relevant adjustment of £12.7 million as set out in Table A2.1.

London's claim is based on an extrapolation of its 2013-2014 actual costs and forecast workload as reported in the 2013-14 RRPs. We have concerns over the use of only one year's actual data as a basis for future costs and we may update our proposed determination when we receive the 2014-15 actual reported data due at the end of July.

In addition, when considering future costs and workloads London did not take into consideration any efficiencies or impact of innovation. NGGD has previously referred to the benefits of innovation in other publications such as its 2013-14 annual report commentary and in its recent DRS submission. NGGD have referred to maximising the use and benefits of innovation and in its recent DRS submission it discussed the tangible benefits of innovation such as reducing the amount of excavation by using core and vac; using CISBOT to reduce the number of excavations; trialling PRISM which may reduce a job from one week to one day.

However, London has demonstrated improvements in its management of lane rental. In previous reopener claims during GDPCR1, London was not able to provide robust evidence that processes were in place for taking the optimal course of action for lane rental. In its current submission, London has shown evidence of improved processes and better management of costs. Nevertheless, London has not considered efficiencies or the impact of innovation in forecasting future costs.

In addition to adjustments made to specific cost categories of London's claim we have also applied a three per cent annual cumulative reduction to reflect efficiencies and impact of innovation across all cost categories starting from 2015.

Table A2.1 – London's proposed relevant adjustment application and Ofgem's proposed adjustment

London *2014/15 prices*	GDN's proposed adjustment	Ofgem's proposed adjustment
Permit fees	£2.8 m	£2.4 m
Administration costs	£1.2 m	£1.1 m
Productivity	£4.8 m	£4.2 m
Lane rental	£5.5 m	£5.0 m
Total	**£14.3 m**	**£12.7 m**

The key areas under review for London are permit fees, administration costs, productivity cost impacts and lane rental.

Permit fees

The total costs claimed under this category are £2.8 million and we are minded to allow efficient costs of £2.4 million.

London's submission

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London claimed that there is a greater level of traffic sensitive streets in London due to heavy trafficked roads which significantly increase the proportion of major roads (0,1,2) and traffic sensitive road permits leading to an increase in net average permit cost of £71 per permit.

London's claim for permit fees, both costs and number of permits, is based on the 2014 actual costs and workload and extrapolated for future years. The number of permits is calculated by reference to the movement in mains replacement workload, repairs workload and the number of HA operators. The costs are then derived by applying the 2014 unit cost against the forecast workload.

Our minded-to position

The overall number of permits in 2014 are 4,616, made up of permits granted (3,293 and 71.3%) and permit variations (1,323 and 28.7%). London did not provide any evidence to explain or support the number of variations reported. We appreciate that variations may be requested by HAs but we consider there is an opportunity for GDNs to be more efficient. We are minded to reduce the number of variation permits to reflect efficiencies in GDN behaviour and planning. We propose to reduce the level of variations to 25% for each year claimed. We have also applied a three per cent annual cumulative reduction from 2015 onwards to reflect efficiencies and the impact of innovation.

Administration costs

The total costs claimed under this category are £1.2 million and we are minded to allow efficient costs of £1.1 million.

London's submission

London's claim includes costs for back-office administration, traffic management plans and site meetings with an average cost per project of £480.

Our minded-to position

We accept London's unit cost of £480 per project for the first year, but we are minded to apply a three per cent annual cumulative reduction to reflect efficiencies and impact of innovation from 2015.

Productivity costs

The total costs claimed under this category are £4.8 million and we are minded to allow efficient costs of £4.2 million.

London's submission

London's claim for productivity equates to a unit cost per metre of £4.86 for each year over the eight year period.

London claimed that increased costs in productivity were primarily driven through the imposition of restrictive conditions placed upon them by the permitting authorities. The greatest impact for London is the 'road space conditions' that have a severe impact on limiting the working zone and reducing efficiency of the teams.

Our minded-to position

We are minded to accept London's unit cost of £4.86 per metre, however London has not considered the efficiencies or impact innovation in its claim. London submitted a detailed

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analysis of the conditions it is impacted by for 2014, to support costs associated with productivity, but no consideration has been given to efficiencies or the impact of innovation in its forecast for future years.

We have therefore applied a three per cent annual cumulative reduction to take into account efficiencies and the impact of innovation.

Lane rental

The total costs claimed under this category are £5.5 million and we are minded to allow efficient costs of £5 million.

London's submission

London's claim for lane rental is split into two areas – lane rental relating to day to day activities (£4 million) and lane rental for London Medium Pressure Replacement Scheme (LMPRS) (£1.5 million).

Our minded-to position

We recognise the work done by London in better managing its lane rental process and costs for lane rental charges. However, we believe there is an opportunity for efficiencies and innovation to better deliver streetworks in its network and have therefore applied a three per cent annual cumulative reduction to its proposed forecast adjustment.

Our consultant concluded that the evidence provided for lane rental is comprehensive and that NGGD have mitigated the potential cost of fees although the use of innovation would benefit where lane rental is applied by, for example, the reduction of the duration of works.

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Appendix 3 – Detailed analysis of North West's claim

This appendix sets out the detailed analysis of the proposed adjustments against North West's application and the rationale behind this.

North West submitted a claim for £9 million, of which 52 per cent related to permits and 39 per cent to productivity related costs. After assessing North West's application and based on the evidence provided, we are minded to allow an efficient relevant adjustment of £6.8 million as set out in Table A3.1.

North West's claim is based on an extrapolation of its 2013-2014 actual costs and forecast workload as reported in the 2013-14 RRPs. We have concerns over the use of only one year's actual data as a basis for future costs and we may update our proposed determination when we receive the 2014-15 actual reported data due at the end of July.

In addition, when considering future costs and workloads North West did not take into consideration any efficiencies or impact of innovation. NGGD has previously referred to the benefits of innovation in other publications such as its 2013-14 annual report commentary and in its recent DRS submission. NGGD have referred to maximising the use and benefits of innovation and in its recent DRS submission it discussed the tangible benefits of innovation such as reducing the amount of excavation by using core and vac; using CISBOT to reduce the number of excavations; trialling PRISM which may reduce a job from one week to one day.

In addition to adjustments made to specific cost categories of North West's claim we have also applied a three per cent annual cumulative reduction to reflect efficiencies and impact of innovation across all cost categories starting from 2015.

Table A3.1 – North West's proposed relevant adjustment application and Ofgem's proposed adjustment

North West *2014/15 prices*	GDN's proposed adjustment	Ofgem's proposed adjustment
Permit fees	£4.6 m	£2.9 m
Administration costs	£0.9 m	£0.8 m
Productivity	£3.5 m	£3.1 m
Total	**£9.0 m**	**£6.9 m**

The key areas under review for North West are permit fees, administration costs and productivity cost impacts.

Permit fees

The total costs claimed under this category are £4.6 million and we are minded to allow efficient costs of £2.9 million.

North West's submission

North West claimed that permit schemes in its network apply to all roads which attracts lower fees with minor roads (3 and 4) comprising over 80% of the road network, therefore higher volumes of work. However, permit costs in the North West are greater due to the application and fees applying to all roads.

North West's claim for permit fees, both costs and number of permits, is based on the 2014 actual cost and workload data and extrapolated for future years. The number of permits is calculated by reference to the movement in mains replacement workload, repairs workload

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and the number of HA operators. The costs are then derived by applying the 2014 unit cost against the forecast workload.

Our minded-to position

The overall number of permits in 2014 are 11.425, made up of permits granted (6,082 and 53%) and permit variations (5,343 and 47%). North West did not provide any evidence to explain or support the number of variations reported. We appreciate that variations may be requested by HAs but we consider there is an opportunity for GDNs to be more efficient. We are minded to reduce the number of variation permits to reflect efficiencies in GDN behaviour and planning. We are therefore minded to reduce the level of variations to 25% for each year claimed. We have also applied a three per cent annual cumulative reduction to reflect efficiencies and the impact of innovation.

Administration costs

The total costs claimed under this category are £0.9 million and we are minded to allow efficient costs of £0.8 million.

North West's submission

North West's claim includes costs for back-office administration, training, pre-site surveys, site meetings and other administration costs with an average cost per project of £207.

North West comment that its unit cost is less than the other Networks which is partly driven by the reduced use of traffic management provisions conditions (which require the development and provision of traffic management plans).

Our minded-to position

We are minded to accept North West's unit cost of £207 per project for the first year, but we are minded to reduce costs by a three per cent annual cumulative reduction to reflect efficiencies and impact of innovation from 2015.

Productivity costs

The total costs claimed under this category are £3.5 million and we are minded to allow efficient costs of £3.1 million.

North West's submission

North West's claim for productivity equates to a unit cost per metre of £3.06 for each year over the eight year period, which applies to 23% of the workload as the permit scheme applies to all roads.

North West claimed that increased costs in productivity were primarily driven through the imposition of restrictive conditions placed upon them by the permitting authorities. The greatest impact for North West is the 'timing and duration conditions' which increased costs through overtime to reduce overall job duration or loss of productivity as works were restricted at certain periods of the day.

Our minded-to position

North West has not considered the impact of efficiencies and innovation in its claim. We are minded to accept its unit cost of £3.06 per metre for the first year, but we are applying a three per cent annual cumulative reduction to reflect future efficiencies and impact of innovation.

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Appendix 4 – Financial mechanisms for price control variable value re-openers

The mechanism for implementation of adjustments to the variable value re-openers within the price control period will follow the procedures as outlined in the financial handbook Chapter 7 for Gas Distribution and can be outlined as follows:

Revision to the allowances will be implemented through the Price Controls Financial Model as part of the Annual Iteration Process. The changes to the allowances will impact on the value of MOD through changes in Totex[16].

Treatment on the revision of allowed Totex will be subject to the Totex Incentive Mechanism (TIM), whereby, subject to the various capitalisation rates across Gas Distribution; Totex will be split into fast pot expenditure and slow pot expenditure.

Fast pot expenditure is treated as revenue and will inform the changes to base revenue. Slow pot expenditure is added to the Regulatory Asset Value (RAV) and is recovered over the life of the RAV through regulatory depreciation and return.

The revenue impact and the customer bill impact across the price control period based on the GDN submissions and our proposed adjustments are set out in tables A4.1 and A4.2 below.

Table A4.1 – revenue impact

Revenue impact - GDN proposed adjustments *2014/15 prices*	**2016-17**	**2017-18**	**2018-19**	**2019-20**	**2020-21**
East of England	£2.8 m	£0.8 m	£0.7 m	£0.7 m	£0.7 m
London	£4.5 m	£1.1 m	£1.0 m	£1.0 m	£1.0 m
North West	£2.5 m	£0.7 m	£0.7 m	£0.7 m	£0.6 m
Revenue impact - Ofgem proposed adjustments *2014/15 prices*	**2016-17**	**2017-18**	**2018-19**	**2019-20**	**2020-21**
East of England	zero	zero	zero	zero	zero
London	£4.1 m	£0.9 m	£0.9 m	£0.9 m	£0.8 m
North West	£2.0 m	£0.5 m	£0.5 m	£0.5 m	£0.5 m

Table A4.2 – customer bill impact

Annual bill impact - GDN proposed adjustments £'s *2014/15 prices*	**2016-17**	**2017-18**	**2018-19**	**2019-20**	**2020-21**	**Annual average 2016-2021**
East of England	0.66	0.18	0.18	0.17	0.17	0.27
London	1.57	0.38	0.37	0.36	0.35	0.60
North West	0.81	0.23	0.22	0.21	0.21	0.34
Annual bill impact - Ofgem proposed adjustments £'s *2014/15 prices*	**2016-17**	**2017-18**	**2018-19**	**2019-20**	**2020-21**	**Annual average 2016-2021**
East of England	zero	zero	zero	zero	zero	zero
London	1.45	0.33	0.31	0.30	0.29	0.54
North West	0.66	0.17	0.16	0.16	0.15	0.26

[16] Totex means total expenditure

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Appendix 5 - Extract from Special Condition 3F. Arrangements for the recovery of uncertain costs – definition of 'specified streetworks costs'

Specified Street Works Costs	means costs specified below that have been incurred, or are expected to be incurred, by the Licensee in complying with obligations or requirements arising under any orders or regulations made pursuant to Part 3 of the Traffic Management Act 2004 (or, in Scotland, the Transport (Scotland) Act 2005) that impose a permit scheme, or under any wider street works legislation applicable to the Licensee: (a) one-off set-up costs; (b) permit fee costs; (c) administrative costs arising from the introduction of permit schemes; (d) costs arising from the introduction of permit conditions; (e) costs arising from changes to working practices required by the introduction or alteration of any code of practice applicable to the Licensee; (f) costs arising from lane rental charges levied on the Licensee by highway authorities; (g) costs arising from changes to inspection fees payable by the Licensee; (h) costs arising from changes to the requirements imposed on the Licensee in respect of highway reinstatement; and (i) costs arising from the introduction of new congestion charging schemes or changes to existing ones. as further clarified in the RIGs;

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Appendix 6 – Consultant's Report – Les Guest Associates

We employed the services of Les Guest Associates in order to provide an independent assessment of NGGD's claim. We requested an opinion on the following:

- Do you consider the costs claimed specifically relate to the introduction of the TMA or do they relate to NRSWA eg costs that are being incurred by other GDNs

- Do you consider the applications to be reasonable in the following areas:

    - Permits;
    - Administration;
    - Productivity; and
    - Lane Rental

During the process, we shared all information relating to NGGD's application with the consultant.

Our consultant focussed on 2013-14 costs only and was not in a position to challenge future workload and efficiencies and whether the extrapolation methodology for future years was correct.

Our consultant concluded that although costs appear to be reasonable for most areas, additional evidence would be required to fully justify the applications in other areas such as permit variations and administration costs.

Our consultant concluded that the evidence for lane rental is comprehensive and that NGGD have mitigated lane rental costs due to its effective processes in place.

We broadly accept the consultants' opinion for most cost categories, and agree and consider that the evidence provided is not sufficiently robust in certain areas.

The report can be accessed here. [17]

[17] https://www.ofgem.gov.uk/sites/default/files/docs/2015/07/les_guest_associates_-_streetworks_review.pdf

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Appendix 7 – GDN Submissions

The GDN submissions have been redacted for confidential and commercially sensitive material. The links to the report can be found here.[18]

[18] https://www.ofgem.gov.uk/sites/default/files/docs/2015/07/nggd_streetworks_reopener_submission_v2.0_-_redacted_230715.pdf

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