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1st September 2015.

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

Dear Mick,

Consultation on Ofgem's minded-to position for the review of costs associated with the TPCR4 enhanced physical security upgrade programme and the RIIO-T1 and RIIO-GD1 enhanced physical site security uncertainty mechanisms

Thank you for the opportunity to respond to the above consultation. This is a non-confidential response on behalf of the Centrica Group, excluding Centrica Storage.

We do not believe that providing allowances for projects for which Value for Money (VFM) reports have not been submitted has been justified. In particular:

- **Evidence required by Ofgem has not been provided.**
- **We are unclear how assurance can be provided over the cost efficiency of projects included in the RIIO-T1 and RIIO-GD1 reopener applications for which the evidential requirements have not been satisfied.**
- **Resubmissions may be made during the 2018 reopener application window.**

Additionally, it is not clear to us how the timescales for this consultation process allow for stakeholder views to be fully taken into account.

Evidence required has not been provided

We are supportive of the approach taken to assess the cost efficiency of expenditure associated with the TPCR4 enhanced physical security upgrade programme. We believe the value of independent audits for each project has been demonstrated by the fact that inefficiencies were identified, which otherwise might have been difficult to identify. Independent assessments provide stakeholders with comfort that only efficiently-incurred costs are remunerated and the projects deliver value for money.

We are unaware of the reasons why VFM reports were not submitted for all projects included in the RIIO-T1 and RIIO-GD1 uncertainty mechanism applications. We believe network owners (NWOs) should have reasonably expected these reports would be required given the approach to the assessment of the TPCR4 upgrade programme. We suggest NWOs must have recognised the submission of such reports is a requirement to be satisfied in order to comply with the reopener application criteria. This requirement and the purposes for which the reports would be used were stipulated in Final Proposals for the RIIO-T1 price control¹:

In relation to enhanced security costs, the TO will be required to provide evidence that project costs are efficient. Part of this evidence will be a requirement to provide details of the auditing process that projects have gone through. We outlined this approach in our March Strategy Document. There are likely to be two stages to the audit process, ie an audit prior to work commencing and an audit after work is completed. The audits will include information on whether the work meets the operational requirements for physical security and recommendations on whether the costs of the work represent value for money.

If the reopener mechanism is triggered we will consider making provision for expenditure yet to be incurred, as well as reimbursing the network company for efficient costs already incurred. Our ex post assessment to determine the efficiency of the costs incurred will take account of the recommendations in the audits submitted by the network companies and, where appropriate, we will benchmark costs across the network companies. In providing an ex ante allowance we will consider the certainty of the work commencing, which will require the network company to provide the initial audits that have been undertaken, and the efficiency of the expected costs.

Similarly, in Final Proposals for the RIIO-GD1 price control²:

As outlined in our March Strategy Document a GDN will be required to provide evidence that project costs are efficient. Part of this evidence will be a requirement to provide details of the auditing process that projects have gone through. There are likely to be two stages to the audit process: an audit prior to work commencing and an audit after work is completed. The audits will include information on whether the work meets the operational requirements for physical security and recommendations on whether the costs of the work represent value for money.

If the reopener mechanism is triggered we will consider making provision for expenditure yet to be incurred, as well as reimbursing the network company for efficient costs already incurred. Our ex post assessment to determine the efficiency of the costs incurred will take account of the recommendations in the audits submitted by the network companies and, where appropriate, we will benchmark costs across the network companies. In providing an ex ante allowance we will consider the certainty of the work commencing, which will require the network company to provide the initial audits that have been undertaken, and the efficiency of the expected costs.

Final Proposals (for both T1 and GD1) state that network companies are required to provide initial audits. It does not, therefore, appear that the NWOs have provided all the evidence identified as necessary to support the submissions. We note also that it is not clearly explained why the requisite VFM reports were not provided or the impact on the assessment process, in particular why this may be acceptable. The approach would also appear inconsistent with Ofgem's draft decision to reject

¹ RIIO-T1: Final Proposals for National Grid Electricity Transmission and National Grid Gas: Cost assessment and uncertainty Supporting Document para 3.35-3.36

(https://www.ofgem.gov.uk/sites/default/files/docs/2012/12/3_riiot1_fp_uncertainty_dec12.pdf)

² RIIO-GD1: Final Proposals - Finance and uncertainty supporting document: Finance and uncertainty supporting document para 8.46-8.47

(https://www.ofgem.gov.uk/sites/default/files/docs/2012/12/3_riiogd1_fp_finance_and_uncertainty_0.pdf)

NGGT's application for additional funding for RIIO-T1 Compressor Emissions costs primarily due to NGGT's failure to fulfil the specific requirements set out for the re-opener submission.

Limited assurance over the cost efficiency of projects included in the reopener applications

Given that it does not appear to us that NWOs have provided all the evidence identified as necessary to support the submissions, it is unclear how robust cost assessments can be conducted to justify additional allowances for some networks during this application window.

Resubmissions during the 2018 reopener application window

We recommend that reopener applications for projects for which the necessary supporting evidence has not been provided should not progressed at this stage. In that case, NWOs will still be permitted to resubmit these applications for additional allowances during the 2018 reopener application window. In such a scenario, we would expect networks to fully satisfy the criteria set out for the reopener applications at Final Proposals.

Insufficient opportunity for stakeholders' views to be taken into account

We do not believe that sufficient time has been allowed for stakeholders' views to be taken into account during the assessment of the network operators' (NWOs') proposals. We recognise that the NWOs' special licence conditions³ stipulate adjustments will default to those proposed by the NWOs unless a decision is made within four months of the receipt of applications and so restricts the process. For example, special condition 6H.16 of National Grid Electricity Transmission's licence states:

"If the Authority has not determined a relevant adjustment in relation to a proposal duly made by the licensee under paragraph 6H.5 of this condition within four months after the close of the relevant application window, and the proposal has not been withdrawn, then the relevant adjustment, insofar as it relates to changes to Allowed Expenditure levels for the licensee for Relevant Years specified in the proposal, will be deemed to have been made."

Stakeholders have been invited to comment on the proposals for additional allowances no later than one month after this consultation was published, which was published two months after the close of the 2015 reopener application window⁴. We believe a consultation period of only month is insufficient for stakeholders other than NWOs to properly assess the proposals. We also believe that the remaining one month period before the assessment process must end places a significant constraint on the opportunities for any material issues highlighted by stakeholders to be properly considered.

³ Special condition 6H.16 of National Grid Electricity Transmission's (NGET's), special condition 5E.18 of National Grid Gas Transmission's (NGGT's) and special condition 3F.20 of National Grid Gas Distribution's (NGGD's) and Scotia Gas Networks' (SGN's) licences.

⁴ Special condition 3F.10 of the GDNs' licences states the application window closes on May 31, 2015.

We suggest that, in the future, the NWOs' applications are published as soon as possible of submission in order to give non-NWO stakeholders early sight and greater opportunity to assess the requests.

Answers to the consultation questions are provided in appendix 1 below. We hope you find our comments helpful. Please do not hesitate to contact me if you have any questions.

Yours sincerely,

Andy Manning
Head of Network Regulation, Forecasting and Settlements

Appendix 1: Consultation Questions

Question 1: Do you agree with our assessment and proposed adjustments associated with TPCR4 enhanced physical site security costs for the four Transmission Owners (TOs), NGET, NGGT, SHE Transmission and SPTL?

As explained above, we are supportive of the approach taken to assess the cost efficiency of expenditure associated with the TPCR4 enhanced physical security upgrade programme. We believe the value of independent audits for each project has been demonstrated by the fact that inefficiencies were identified, which otherwise might have been difficult to identify. Independent assessments provide stakeholders with comfort that only efficiently-incurred costs are remunerated and the projects deliver value for money.

Question 2: Do you agree with our assessment and proposed adjustments associated with the RIIO-T1 enhanced physical security costs for the two TOs, NGET and NGGT?

Although we are unable to fully assess the appropriateness of the proposed adjustments from the information provided, and notwithstanding our overriding concern set out above that the re-opener applications should only progress if the evidence provided satisfies the criteria set out in Final Proposals, the comparative assessment of each component of expenditure associated with the delivery of these types of projects seems broadly sensible. Further details would be useful to aid understanding. For example, it is proposed to disallow a proportion of NGET's and NGGT's costs relating to general items and preliminaries in order to align them with the average level of costs. However, it is not clear whether costs submitted by these TOs were included in the derivation of the average level of costs. The proposed adjustments would not entirely remove inefficient costs if the derivation of the 'reference' average level of costs included costs submitted by NGET and NGGT.

Question 3: Do you agree with our assessment and proposed adjustments associated with the RIIO-GD1 enhanced physical security costs for the five GDNs (NGGD's East of England, London, North West networks, and SGN's Scotland and Southern networks)?

Although we are unable to fully assess the appropriateness of the proposed adjustments from the information provided, and notwithstanding our overriding concern set out above that the re-opener applications should only progress if the evidence provided satisfies the criteria set out in Final Proposals, the comparative assessment of each component of expenditure associated with the delivery of these types of projects seems broadly sensible.

Question 4: Do you agree with our proposal to introduce an output commitment in relation to enhanced physical security?

The proposal to introduce an output commitment seems sensible.