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RIIO-T1 Reopener Consultation – Enhanced Security Costs

Consultation

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Response deadline: 29 August 2018

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Overview:

The RIIO-T1 price control includes two reopener windows for companies or Ofgem to propose adjustments to expenditure allowances for certain categories of costs that were deemed to be uncertain at the time of our Final Proposals.

This document sets out our initial views on National Grid's application under the "Enhanced Security costs" category of uncertain costs, which relates to the costs of enhancing the security of IT systems operated by National Grid in its role as the system operator for the electricity and gas networks in Great Britain.

The sensitive nature of the application means that it is not possible to carry out a public consultation on our full assessment of National Grid's application. This document provides a non-confidential overview of our assessment. We have provided National Grid with a confidential document setting out our full assessment.

We welcome your views on any of the issues set out in this document. Responses should be addressed to gasnetworks@ofgem.gov.uk no later than 29 August 2018. Unless clearly marked as confidential, responses will be published on our website. We will consider the response as part of our final determination which we will publish by the end of September 2018.

Context

RIIO-T1 and GD1 were the first price controls to reflect the new RIIO (Revenue = Incentives + Innovation + Outputs) model. The RIIO-T1 price control sets the outputs that the electricity and gas transmission network companies need to deliver for consumers and the associated revenues they are allowed to collect for the eight year period from 1 April 2013 until 31 March 2021.

For cost categories where there was significant uncertainty about expenditure requirements at the time of setting allowances, the price controls include a "reopener" mechanism. The mechanism allows network companies to propose adjustments to baseline expenditure allowances for these costs when there is more certainty. The reopener mechanism specifies two windows during which adjustments to allowances may be proposed – one in May 2015 and other in May 2018.

We have received reopener submissions for following cost categories:

- One-off Asset Health Costs (Feeder 9)
- Industrial Emissions Costs
- Enhanced Security Costs
- Enhanced Physical Site Security Costs
- Quarry and Loss Development Claim Costs
- Street Works Costs

The reopener process fits into priorities 3 and 4 of the 2018-2019 Ofgem Corporate Strategy.

We are required to make a determination by 30 September 2018 on any application received through the reopener process.

Associated documents

National Grid Gas PLC (NTS) Gas Transporter Licence, Special Conditions

National Grid Electricity Transmission plc, Electricity Transmission Licence, Special Conditions

Informal consultation on RIIO-1 price control reopeners (May 2018)

RIIO-T1: Final Proposals for National Grid Electricity Transmission and National Grid Gas

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

RIIO-T1: Initial Proposals for National Grid Electricity Transmission and National Grid Gas

Contents

Executive Summary

Enhanced Security costs are the costs required to enhance the security of the IT systems needed to operate the gas and electricity transmission systems.

At the time of setting our RIIO-T1 price controls, there was considerable uncertainty over future government recommendations or statutory requirements on the security of IT systems. We provided National Grid Electricity Transmission (NGET) and National Grid Gas Transmission (NGGT) a combined allowance of £6.2m for three cyber security investments and £25.2m to cover necessary refurbishments and upgrades of their data centres.

In May 2018 we received a reopener application from National Grid (NG) for both its gas and electricity transmission licensees for Enhanced Security costs, totalling £125.3m.[1] We have assessed the submission and our initial view is to allow £107.1m. If confirmed by us in our final decision, these costs will then be paid by consumers through the networks charges element of their energy bills.

We do not propose to allow the following elements of NG's submission:

- We do not think NG has justified £9.8m of its programme management, risk and some specific costs relating to data centre investments.
- We propose a reduction of £8.3m relating to cyber security. This accounts for ongoing efficiency savings, internal resource costs that we think are too high, and an overlap with some areas that we have previously funded through the RIIO-T1 allowances.

Next steps

This consultation will close on 29 August 2018. Please send in your response by emailing us at gasnetworks@ofgem.gov.uk.

In proceeding with a 21-day consultation we welcome engagement from interested stakeholders during the consultation period. The shorter period is driven by the licence requirement to conclude by the end of September and the time we need to respond more fully to comments made in the consultation, engage with interested stakeholders and revise our analysis if required.

Our decision will be implemented through the 2018 Annual Iteration Process, which means that any adjustments to NGET and NGGT's allowed revenues will take effect from 2019/20.

[1] All costs in this document are reported in the 2009/2010 price base, unless otherwise stated.

1. Introduction

1.1. At the time of setting RIIO-T1 allowances, there was uncertainty about the costs relating to future recommendations or requirements on cyber security and data centres. We therefore included a reopener mechanism for Enhanced Security costs to review uncertain System Operator (SO) costs required to enhance the security of IT systems required to operate National Grid's (NG) transmission networks. The reopener mechanism applies to both National Grid Electricity Transmission (NGET) and National Grid Gas Transmission (NGET) and includes two application windows, May 2015 and May 2018.

1.2. Enhanced Security costs are defined in Special Condition 7D of NGET's electricity transmission licence and Special Condition 6D of NGGT's gas transporter licence as:

> *"'…costs incurred, or expected to be incurred, by the licensee for the purposes of implementing any formal recommendation or requirement of the Secretary of State to enhance the security of any of the IT systems required to operate the licensee's Transmission System."*

1.3. No application for funding was made during the 2015 reopener window. In May 2018 we received a formal joint reopener application from NGET and NGGT requesting to increase their allowances by £125.3m for Enhanced Security costs, which covers enhancements to data centres (£84.8m) and cyber security (£40.5m).[2]

1.4. NG's application contains sensitive information that cannot be placed in the public domain. This document provides a non-confidential overview of our assessment. We have provided NG with a confidential document setting out our full assessment.

What allowances were provided for Enhanced Security costs as part of RIIO-T1?

1.5. In RIIO-T1 Final Proposals, we included an allowance of £12.6 million each to NGET and NGGT for data centres to cover necessary refurbishments and upgrades.

1.6. NG also received £6.2m within the RIIO-T1 allowances for three cyber security investments.

[2] All costs in this document are reported in the 2009/2010 price base, unless otherwise stated.

2. Our assessment of the submission

Question box
We are interested in your views on these questions:

Question 1: Do you have any views on our assessment approach?

Question 2: Do you have any views on the outcome of our assessment?

Our approach to the assessment

2.1. We considered the following questions when assessing NG's submission:

- Is the proposed investment proportionate and necessary to comply with the Network and Information Systems (NIS) Directive, respond appropriately to cyber security threats and meet the high-level recommendations or requirements of the Department of Business, Energy and Industrial Strategy and the National Cyber Security Centre?
- Has NG properly considered the appropriate options for meeting the need?
- Are the requested costs efficient?

2.2. We commissioned an independent cyber-security expert from PA Consulting to inform our assessment. Our consultant's recommendations have been considered and incorporated into our proposals.

Data Centre Investments

2.3. NG is requesting a total of £84.8m for enhancements to its data centres. We propose to allow **£75.0m** of these costs.

2.4. The development of NG's data centre investment programme has been informed by a number of consultancy reports which it commissioned. We are satisfied that the need for the requested investment is proportionate and necessary and that NG has properly considered the appropriate options for data centre investment.

2.5. In our consultant's view, based on benchmarks from comparable projects, the costs relating to resource are relatively high for this type of project and NG's risk allowance is too high, so we are proposing to reduce the costs in these areas. We are also proposing to reduce the programme cost to 15% of the total project cost, which is in line with our view of the efficient benchmark of project management costs for comparable large projects.

Cyber Security Enhancements

2.6. NG is requesting £40.5m for cyber security enhancements. We propose to allow **£32.2m** for this programme of work. We also propose adding a condition to the funding for NG to deliver a set of outputs.

2.7. Our initial view is that the proposed cyber security enhancements are proportionate and necessary due to the increased cyber security threat level and NG's requirements under the NIS Directive.

2.8. NG commissioned a number of consultancy assessments. These consultancy reports informed the development of the cyber security enhancements.

2.9. NG has demonstrated its work to drive down unit costs by various means. However, our consultant has advised that additional efficiency savings can be made by applying the lessons learnt from projects as they are completed. Our consultant advised that the risk level, resourcing and project management costs were high compared to similar projects, so we have reduced the allowances in these areas. As such, we are proposing to reduce the cyber security enhancement costs by £3.6m.

2.10. We had previously provided funding of £6.2m within the RIIO-T1 allowances for three cyber security investments. We think that NG's current proposals for cyber security projects under the 2018 reopener overlap with the projects that were previously funded. Based on information provided by NG, we propose to reduce NG's current funding request by £4.7m to take account of this overlap. We propose to apply this reduction across the first three years of the programme.

3. Our initial view

Question box
We are interested in your views on these questions:

Question 3: Do you have any views on our proposal to link the funding of the cyber security programme to the delivery of an output?

Question 4: Do you have any views on our drafting of the proposed output?

Our initial view on NG's allowed expenditure request

3.1. Our initial view is to allow £107.1m of NG's £125.3m requested expenditure allowance. Table 1 provides a breakdown of our minded to position.

	NG requested allowed expenditure for RIIO-T1 (09/10 prices	Ofgem proposed allowed expenditure for RIIO-T1 (09/10 prices)	Difference
Data Centre Investments	£84.8m	£75.0m	£9.8m
Cyber Security Enhancements	£40.5m	£32.2m	£8.3m
Total	**£125.3m**	**£107.1m**[3]	**£18.1m**

Table 1. The requested and proposed expenditure for NG's Enhanced Security costs during the RIIO-T1 period.

Proposed condition of funding the cyber security programme

3.2. While our initial view is that NG's proposed investment in its cyber security programme is a reasonable response to the current threat level and government recommendations and requirements, we believe that there is some delivery risk associated with these projects. In particular, given the wide ranging scope of the programme, we think it would be a challenge to deliver all of the planned improvements to cyber security and the associated benefits within the RIIO-T1 period.

3.3. For this reason, we think it is appropriate and in the interest of consumers for the funding to be linked to the delivery of clear outputs that we will specify as part of the reopener decision.

[3] Please note there is a rounding error in this table.

3.4. We propose the output is defined as follows:

- For the remainder of the RIIO-T1 period, National Grid must submit a six-monthly report to the Competent Authority (CA) on the progress made in the of delivery of the cyber security enhancement initiatives detailed in the May 2018 Enhanced Security reopener submission. Ofgem will provide a template for the six-monthly report. The report covering the period 1 July to 31 December should be submitted by 28 February of the following year, and the report covering the period 1 January to 30 June should be submitted by 31 August of the same year. The first report should cover the period 1 July 2018 to 31 December 2018 and be submitted by 28 February 2019.
- Where changes are made to the programme(s) described in the Enhanced Security reopener submission, these must be outlined and explained in National Grid's report.
- The CA will assess the report to determine whether National Grid has made appropriate progress and provide a written view to National Grid on this.
- As part of RIIO-T1 closeout, the CA will provide a final view to National Grid and the Ofgem RIIO Price Control team on whether the cyber security enhancement initiatives funded through this reopener mechanism have been delivered. Where initiatives have not been delivered, the CA will provide a view to whether non-delivery was appropriate due to any:
    - changes to the threat landscape; and/or
    - appropriate alternative work has been done to deliver the same benefits; and/or
    - the initiatives have been reprioritised based on NIS assessments and/or follow-up audits.
- If Ofgem deems that there was inappropriate non-delivery of initiatives funded through the reopener, we reserve the right to make appropriate adjustments to RIIO-T1 allowances to take account of this non-delivery when making our final decision on RIIO-T1 closeout.

Next Steps

3.5. This consultation will close on 29 August 2018. Please send in your response by emailing us at gasnetworks@ofgem.gov.uk.

3.6. In proceeding with a 21-day consultation we welcome engagement from interested stakeholders during the consultation period. The shorter period is driven by the licence requirement to conclude by the end of September and the time we need to respond more fully to comments made in the consultation, engage with interested stakeholders and revise our analysis if required.

3.7. Our decision will be implemented through the 2018 Annual Iteration Process, which means that any adjustments to NGET and NGGT's allowed revenues will take effect from 2019/20.

Appendix 1 - Feedback on this consultation

How to respond

1.1 We want to hear from anyone interested in this consultation. Please send your response to the person or team named on this document's front page.

1.2 We've asked for your feedback in each of the questions throughout. Please respond to each one as fully as you can.

1.3 We will publish non-confidential responses on our website at www.ofgem.gov.uk/consultations, and put it in our library.

Your response, data, and confidentiality

1.4 You can ask us to keep your response, or parts of your response, confidential. We'll respect this, subject to obligations to disclose information, for example, under the Freedom of Information Act 2000, the Environmental Information Regulations 2004, statutory directions, court orders, government regulations or where you give us explicit permission to disclose. If you do want us to keep your response confidential, please clearly mark this on your response and explain why.

1.5 If you wish us to keep part of your response confidential, please clearly mark those parts of your response that you *do* wish to be kept confidential and those that you *do not* wish to be kept confidential. Please put the confidential material in a separate appendix to your response. If necessary, we'll get in touch with you to discuss which parts of the information in your response should be kept confidential, and which can be published. We might ask for reasons why.

1.6 If the information you give in your response contains personal data under the General Data Protection Regulations 2016/379 (GDPR) and domestic legislation on data protection, the Gas and Electricity Markets Authority will be the data controller for the purposes of GDPR. Ofgem uses the information in responses in performing its statutory functions and in accordance with section 105 of the Utilities Act 2000. Please refer to our Privacy Notice on consultations.

1.7 If you wish to respond confidentially, we'll keep your response itself confidential, but we will publish the number (but not the names) of confidential responses we receive. We won't link responses to respondents if we publish a summary of responses, and we will evaluate each response on its own merits without undermining your right to confidentiality.