

RIO-T1 Reopener Consultation - Quarry and Loss Development Claims Costs

Consultation

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Contact: Kiran Turner
Team: Network Price Controls
Tel: 0203 263 9867
Email: gasnetworks@ofgem.gov.uk

Overview:

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

This document sets out our initial views on National Grid Gas Transmission's application for an adjustment to its allowed expenditure for Quarry and Loss Development Claims (Q&L) costs during the RIO-T1 price control.

We welcome the views of interested parties on 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 responses 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 Claims Costs
- Specified 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](#)

[Informal consultation on RIIO-1 price control reopeners \(May 2018\)](#)

[National Grid Gas Transmission - Quarry & Loss RIIO-T1 Reopener Submission \(May 2018\)](#)

[RIIO-T1: Final Proposals for National Grid Electricity Transmission and National Grid Gas](#)

[RIIO-T1: Initial Proposals for National Grid Electricity Transmission and National Grid Gas](#)

[The RIIO-GT1 Price Control Financial Model](#)

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Executive Summary

Quarry and Loss Development Claims (Q&L) arise from losses suffered by land owners due to the presence of a gas transmission pipeline affecting the productivity or limiting utilisation of their land. These cover a range of land uses, including farming, quarrying and property developments. National Grid Gas Transmission (NGGT) remunerates claimants for their financial losses once the case has been proven.

Under RIIO-T1, no baseline expenditure was provided to NGGT for Q&L due to the uncertainty of the volume and cost of the claims.

In May 2018 we received a reopener submission from NGGT for Q&L costs, totalling £23.1m.¹ Following our assessment, our initial view is to allow £19.2m. 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.

The areas where we propose to reduce NGGT's requested allowance are:

- A reduction of £1.7m for a claim for loss of mineral development costs at a quarry where we think the liability no longer exists due to a court ruling on the matter.
- A reduction of £2.1m relating to drainage works in the South West. This is because we think NGGT's claimed costs are high compared to works in the rest of Great Britain and could have been more efficiently controlled through its management of contractors.

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 determine any relevant adjustments to NGGT's allowed expenditure by the end of September and the time we need to take into account comments made in response to the consultation, engage with interested stakeholders and revise our analysis if necessary.

Our decision will be implemented through the 2018 Annual Iteration Process, which means that any adjustments to 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. Quarry and Loss Development Claims (Q&L) costs arise from legitimate claims made by land owners to compensate for lost revenue due to the presence of a pipeline affecting the productivity or limiting utilisation of the land. These cover a range of land uses, including farming, quarrying and property developments. National Grid Gas Transmission (NGGT) remunerates claimants for their financial losses once the case has been proven.

1.2. Q&L are defined in Special Condition 1A of NGGT's licence as:

"Quarry and Loss Development Claims: means costs incurred, or expected to be incurred, by the Licensee in relation to settling any claims which have been demonstrably challenged by the Licensee as far as is reasonable regarding both the basis of the claim and the quantum of the compensation sought. For avoidance of doubt the following claims under the terms of the Deed of Easement or Deed of Servitude are included:

- *Loss of crop and drainage;*
- *Loss of land development (including in relation to housing quarrying);*
- *Sterilised minerals*
- *Landfill and tipping; and*
- *Power generation."*

1.3. At the time of setting NGGT's allowances for RIIO-T1, there was uncertainty over Q&L costs. As a result, no allowance was provided to NGGT. Instead, under its licence NGGT was able to apply to the Authority during the May 2015 and 2018 reopener windows for "relevant adjustments" to its allowed expenditure for these costs.

1.4. NGGT made no application during the first application window in 2015. We received a formal application from NGGT in May 2018 requesting an adjustment to its baseline expenditure allowance of £23.1m for Q&L costs.

1.5. Phase one of our assessment of NGGT's application was an informal consultation on its submission from 17 May to 20 June 2018.² We received one response from Centrica, which is published alongside this document.

1.6. Centrica's response raised concerns that NGGT has already received an allowance for Q&L costs as part of RIIO-T1 as set out in our Final Proposals document and therefore no additional funding is needed.³

² [Informal consultation on RIIO-1 price control reopeners \(May 2018\)](#)

³ [RIIO-T1: Final Proposals for National Grid Electricity Transmission and National Grid Gas](#)

1.7. This has brought to light a discrepancy between our Final Proposals document and NGGT's licence and Price Control Financial Model (PCFM). While the Final Proposals document implies that an allowance for Q&L was included, we have reviewed NGGT's licence and the PCFM and are satisfied that no allowance was included for Q&L costs. This was following feedback to our Initial Proposals⁴ from NGGT⁵, who considered that it was not possible to accurately forecast the costs that were likely to be incurred, specifically one-off claims relating to sterilised minerals and loss of development.

1.8. The rest of this document sets out our assessment and initial views.

⁴ [RIIO-T1: Initial Proposals for National Grid Electricity Transmission and National Grid Gas - Overview](#)

⁵ Extract from paragraph 1.72 of Final Proposals on NGGT's view of whether to include an allowance for Q&L: NGGT *"did not see the benefits of [Ofgem's] proposed approach over the existing pass through approach but supported provided actual historic costs could be considered in the proposed reopener windows."*

2. Our assessment of the submission

Chapter Summary:

This chapter contains our assessment of the categories of Q&L costs included in NGGT's reopener submission and sets out our initial view in respect of each.

Question box

Question 1: Do you agree with our assessment approach?

Question 2: Do you agree with our initial view in respect of each category of Q&L costs?

2.1. NGGT has requested adjustments to its allowances for the following categories of Q&L costs:

- loss of crop and drainage
- loss of development
- sterilised minerals – NGGT has included landfill and tipping costs within this category, as those costs are associated.

2.2. No submission was made for costs associated with shallow depth of cover or power generation.

2.3. We considered the following when assessing NGGT's submission:

- Whether the request met the qualifying criteria for Q&L costs.
- If the costs have been efficiently incurred.
- Whether we are satisfied with NGGT's processes for handling claims.
- Whether the forecast expenditure is reasonable.
- If the forecast volumes of claims are reasonable.
- If NGGT has demonstrated that historical claims have been appropriately challenged.

2.4. We set out below our assessment of each Q&L cost category of NGGT's submission.

Loss of crop and Drainage

2.5. The presence of NGGT's pipes can cause land damage, including drainage issues, which can affect agricultural land. NGGT is required to repair the land damage or compensate the land owners for their loss of crop.

Loss of crop

2.6. NGGT requested £7.8m to cover claims relating to loss of crop. Loss of crop payments are divided into two areas: annual claims (£4.3m) and full and final (F&F) settlements (£3.5m). We propose to allow the full request.

Annual claims

2.7. NGGT's process for settling annual claims appears to be reasonable and we think that it has appropriately challenged the claims it has received for loss of crop.

2.8. Based on NGGT's submission, we propose to accept its forecast of annual settlements for the remainder of RIIO-T1. NGGT's requested expenditure allowance is based on known claimants only and has been adjusted for NGGT's forecast of F&F settlements to avoid double-counting.

F&F settlements

2.9. In RIIO-T1, NGGT's policy has shifted towards focusing on F&F settlements rather than annual payments. We think this is a positive approach from NGGT. It is a more cost-efficient way of handling loss of crop claims in the longer term based on the observed settlement values and as such, provides better value for energy consumers.

2.10. Under the F&F approach, NGGT calculates the maximum value that it would be willing to pay for a particular F&F settlement. The majority of F&F settlements have been less than the maximum values calculated by NGGT. For the few that were settled above, we are satisfied with the explanation NGGT provided.

2.11. The F&F claims that NGGT has forecasted are based on known cases where the process is well underway and which are likely to complete within the remainder of RIIO-T1. We are satisfied with NGGT's forecast of F&F settlements.

Drainage

2.12. NGGT requested an allowance of £8.3m to cover the cost of historical and forecast drainage works during the RIIO-T1 period. Actual works cover the period from April 2013 to March 2018. Forecast works cover the period from April 2018 to March 2021.

2.13. During the assessment phase, NGGT told us that it had made an error in its submission, and that its submitted forecast costs for drainage works should be lower by £0.229m. This means that the total requested adjustment is £8.07m. The number of actual completed jobs should also be adjusted downwards (by 8).

2.14. Following our assessment, we propose to make an adjustment to NGGT's allowed expenditure of £6.2m to cover actual and forecast drainage costs.

Our assessment

2.15. NGGT has told us that it has completed 615 jobs (after correcting the error in the submission) across Great Britain in the first five years of RIIO-T1, at a cost of £4.1m.

2.16. As part of our assessment, we looked at the breakdown of costs and volumes by region and year, and our initial view is that the actual reported costs across all regions appear to be reasonable.

2.17. NGGT has also provided forecasts of the number of jobs and costs for all regions in Great Britain. NGGT has forecast that it would carry out a total of 481 jobs at a total cost of £3.9m (after adjusting for the error identified in NGGT's submission). NGGT has used different methods to forecast costs for the South West region and the rest of Great Britain.

2.18. We have looked at NGGT's forecasts of costs and volumes for the South West and the rest of Great Britain.

2.19. For the rest of Great Britain, NGGT has forecast costs of £1.6m to carry out 375 jobs in the last three years of the RIIO-T1 price control. Our initial view is that NGGT's forecasts for the rest of Great Britain are reasonable.

2.20. For the South West region, NGGT has forecast a total cost of £2.37m for 106 jobs. NGGT's submission says that the unit cost for drainage works (i.e. the cost per job) in the South West region (i.e. £24k per job) is significantly higher than the rest of Great Britain (i.e. £4.2k per job).

2.21. NGGT says that the unit cost in the South West region is higher because of contractor resource constraints in the past. As a result of these constraints, NGGT has experienced delays in carrying out drainage remedial works in the South West region for a number of years. These delays have meant that the work required for each job has increased in scope, scale and complexity – leading to higher unit costs.

2.22. Our initial view is that these delays and consequent cost increases should have been managed better by NGGT. NGGT appointed its contractors for the South West region in 2011, and then in 2016, extended the contract by six months. The problems with contractor resources should have been apparent to NGGT early on. In the first two years of the price control, no jobs were completed in the South West (against 251 completed jobs in the rest of Great Britain). It was only by 2017 that NGGT had set up a new contractor framework to tackle these issues.

2.23. As NGGT makes clear in its submission, the higher unit cost in the South West is driven by the increases in scale and complexity of jobs caused by the delay.

2.24. In light of our view that these delays should have been identified and addressed earlier, our initial view is that NGGT's proposed unit cost for the South West region are not efficient. As a result, we have estimated efficient costs for the South West region using NGGT's own forecast unit costs for the other regions (i.e. £4.2k per job).

2.25. Using our view of unit costs, we have estimated efficient costs for the South West region based on a forecast number of jobs of 106 to be £0.45m.

2.26. We have reviewed NGGT's process for assessing and challenging claims relating to drainage works, and our initial view is that the process is reasonable.

Sterilised Minerals

2.27. Where pipelines are in place through land that contains mineral deposits, NGGT may be liable for losses that the land owner may incur as a result of being unable to access those deposits. Given the potential size of claims for such losses, it may be more cost-efficient to divert a pipeline rather than pay compensation. When settlements are made, they are F&F.

2.28. NGGT has separated its submission for sterilised minerals into two areas:

- **General claims** – four settled F&F claims and two future claims forecast to be F&F settled in RIIO-T1.
- **Quarry C** – a significant claim for forecast decommissioning costs of a stretch of pipeline.

General claims

2.29. NGGT has requested £2.5m to cover four settled claims and two future claims in respect of sterilised minerals. NGGT supplied us with details of these cases as part of their non-public submission. We have examined the costs for these cases. We think the costs are reasonable and propose to allow the full amount of allowed expenditure requested.

2.30. Our initial view is that NGGT has demonstrated that its process for challenging claims has reduced both the number of successful claims and has lowered the overall value of payments that could be made. We consider that the costs associated with settled claims have been efficiently incurred by NGGT.

2.31. The two forecast claims are both expected to be settled in RIIO-T1. We accept NGGT's view that is liable for these costs and has reasonable certainty of the forecast value of the claims. Our initial view is that the forecast value of these claims is reasonable.

Quarry C

2.32. NGGT has requested £1.7m to cover future works to decommission a stretch of pipeline which passes through a quarry ('Quarry C'). We do not propose to allow NGGT's request for this claim.

2.33. NGGT's liability to decommission the pipeline is dependent on the claimant's planning application to extend the area of quarrying activities to cover the area in the vicinity of the affected pipeline. The initial decision of the planning authority to grant permission was under judicial review and in April 2018, the claimant's planning permission was revoked, removing any liability that NGGT may have had to compensate the land owner. While it is possible that this decision may be overturned in the future, we consider that NGGT would be unlikely to incur any costs in the RIIO-T1 price control period.

2.34. As a result, we consider there is insufficient certainty around the final outcome and timing of this claim to justify providing NGGT with an allowance. For this reason, our initial view is not to allow NGGT's requested expenditure allowance in respect of this claim.

Loss of development

2.35. Land use and development of land surrounding pipelines is restricted in order to protect NGGT's assets. Land owners can claim for compensation for losses as a result of being unable to use their land due to its close proximity to pipelines.

2.36. NGGT has requested £2.7m to cover seven settled claims and one future claim, which is due to be settled next year. We propose to allow the full amount of allowed expenditure requested as these claims appear reasonable.

2.37. We have examined the processes that NGGT has outlined for establishing and challenging the costs of this claim. NGGT's forecast costs are based on seven previously settled cases, and include the professional and legal costs that it has incurred in establishing liability in previous cases.

2.38. NGGT has also received a further four claims, which are not expected to be settled in RIIO-T1. As a result, the costs for these have not been included as part of the submission.

3. Our initial views

Conclusion on NGGT's allowed expenditure request

3.1. Our initial view is to allow £19.2m of NGGT's £23.1m requested expenditure allowance. Tables 1 and 2 provide a breakdown of this.

Table 1: The requested and proposed allowed expenditure for NGGT's Q&L costs during the RIIO-T1 period.

	NGGT requested adjustment for RIIO-T1 (09/10 prices)	Ofgem proposed adjustment for RIIO-T1 (09/10 prices)	Difference
Loss of crop	£7.8m	£7.8m	£0.0m
Drainage	£8.3m	£6.2m	£2.1m
Loss of land development	£2.7m	£2.7m	£0.0m
Sterilised minerals	£2.5m	£2.5m	£0.0m
Quarry C	£1.7m	£0.0m	£1.7m
Total	£23.1m	£19.2m	£3.8m

3.2. We are proposing to reduce NGGT's requested expenditure allowance by £3.8m to £19.2m. This is due to reducing NGGT's requested allowance for drainage costs in the South West region and not allowing forecast costs for the Quarry C sterilised mineral claim. Our proposed adjustment is above NGGT's materiality threshold of £14.5m for this reopener.

Table 2: Requested and proposed expenditure allowance profile for Q&L.

£m (09/10 price base)	13/14	14/15	15/16	16/17	17/18	18/19	19/20	20/21	Total RIIO-T1
Requested Allowed Expenditure	3.486	1.999	2.098	2.882	3.702	3.476	4.064	1.349	23.057
Proposed Allowed Expenditure	3.486	1.999	2.098	2.882	3.702	2.564	1.514	0.964	19.209

3.3. After we make our decision in September, any expenditure adjustments will be calculated in line with the methodology set out in the RIIO-T1 Price Control Financial Handbook and will be used in the calculation of revised allowed revenue as part of the 2018 Annual Iteration Process and will affect network charges from 2019/20.

3.4. This consultation will run from 8 August 2018 to 29 August 2018. We will consider any responses received before making our final decision, which we will publish by the end of September 2018.

Appendix 1 – Calculating drainage allowances

- 1.1 Here we lay out how we calculated the adjustment for drainage.
- 1.2 We used Table 12 from NGGT’s submission, shown below in Table 3 – modified to show average unit cost, to look at the unit cost for the rest of Great Britain compared to the South West. From this data we can see that the works in the South West region are significantly more expensive than the works for the rest of Great Britain.
- 1.3 We do not propose to allow the higher unit cost for the 106 jobs in the South West. Instead, we have allowed the unit cost that has been estimated for the rest of Great Britain.
- 1.4 We then multiplied the GB forecast average unit cost by the number of remedial jobs (106) to calculate the adjustment for these works.

Table 3: A modified version of NGGT’s submitted Table 12, showing the forecast number of works to be completed by March 2021. The calculated average unit cost has also been included.

	Forecast number of works			Total RIIO-T1 volume	Total RIIO-T1 cost (£m) 09/10 price base	Average unit cost (£) 09/10 price base
	18/19	19/20	20/21			
GB (excluding SW)	125	125	125	375	1.6	£4,267
South West (backlog)	45	42	19	106	2.6	£24,528
Total	170	167	144	481	4.2	

Table 4: Workings for our proposed allowances for the SW drainage works.

	Forecast			Total
	2018/19	2019/20	2020/21	
SW Jobs	45	42	19	106
NGGT’s Request (no. of jobs*£24,528)	£1,103,760	£1,030,176	£466,032	£2,599,968
Our proposed allowance (no. of jobs*£4,267)	£192,015	£179,214	£81,073	£452,302
Reduction (request minus proposed allowance)	£911,745	£850,962	£384,959	£2,147,666

Appendix 2 - 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.