

# Consultation

## RIIO-ED1 Reopener Consultation – Enhanced Physical Site Security Costs

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## Context

The RIIO-ED1 price control sets the outputs that the electricity distribution network companies need to deliver for consumers and the associated revenues they are allowed to collect for the eight-year period from 1 April 2015 until 31 March 2023.

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 a window in May 2019 during which adjustments to allowances may be proposed.

We have received reopener submissions in the following cost categories:

- High Value Project Costs
- Rail Electrification Costs
- Enhanced Physical Site Security Costs
- Specified Street Works Costs

This document sets out our initial views on the applications under the “Enhanced Physical Site Security” category of uncertain costs.

We welcome the views of interested parties on any of the issues set out in this document. Responses should be addressed to [RIIO-ED1@ofgem.gov.uk](mailto:RIIO-ED1@ofgem.gov.uk) no later than Friday 30 August 2019. Unless clearly marked as confidential, responses will be published on our website. We will consider responses as part of our final determination which we intend to publish in October this year.

## Associated documents

[Informal consultation on RIIO-ED1 price control reopeners \(May 2019\)](#)

[RIIO-ED1 Price Control Financial Handbooks \(fast-track and slow-track licensees\)](#)

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## 1. Executive Summary

### What are we consulting on?

- 1.1 When setting the first RIIO electricity distribution price control (1 April 2015 – 31 March 2023), Ofgem introduced a number of mechanisms for the recovery of uncertain costs. Those uncertainty mechanisms included reopeners, which enable adjustments to electricity distribution network operators' allowances to reflect efficient costs associated with specific uncertain cost categories and are set out in Special Condition CRC 3F<sup>1</sup> of the Electricity Distribution Licences.
- 1.2 One of the uncertainty mechanisms relates to those sites which have been designated by the Centre for the Protection of National Infrastructure (CPNI) as requiring enhanced security. Working with the responsible government department, ie the Department for Business, Energy and Industrial Strategy (BEIS), Distribution Network Operators (DNOs) agree and implement the Physical Security Upgrade programme (PSUP), which involves measures required to enhance physical security at Critical National Infrastructure (CNI) sites.
- 1.3 At the time of setting the RIIO-ED1 price controls in 2014, there was uncertainty about the list of sites that required security upgrades and the scope of works required at each site. As a result, we created the Enhanced Physical Site Security Costs reopener to allow for additional costs, beyond those included in any ex ante allowances, incurred by DNOs in complying with the requirement.<sup>2</sup> There is no materiality threshold for this reopener.

### Value for Money Audits

- 1.4 As part of our RIIO-ED1 Strategy Decision,<sup>3</sup> we placed a requirement on DNOs that all funding requests for enhanced security work were required to be accompanied by a Value for Money (VFM) audit report. However, in January 2018 we decided to remove these VFM audit requirements.<sup>4</sup> As part of the May 2019 reopener, we expected licensees to provide sufficient information within their submissions to demonstrate that expenditure incurred, or expected to be incurred, is efficient.
- 1.5 During the May 2019 window we received one submission under the Enhanced Physical Site Security Costs reopener, in which Northern Powergrid (NPg) on behalf of its two licensees, Northern Powergrid Northeast (NPgN) and Northern Powergrid Yorkshire (NPgY), requested an adjustment of £3.01m to their expenditure allowances. We are minded to amend this proposal, and allow NPg £2.95m.
- 1.6 We have published NPg's non-confidential submission alongside this consultation.
- 1.7 Chapter 3 of this document is divided into the following sections:

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<sup>1</sup> Charge Restriction Condition 3F: Arrangements for the recovery of uncertain costs.

<sup>2</sup> At the beginning of RIIO-ED1 we set NPgY an allowance of £1.44m (12/13 prices) for Critical National Infrastructure; we set NPgN a £0m allowance.

<sup>3</sup> [https://www.ofgem.gov.uk/sites/default/files/docs/2013/02/riioed1decuncertaintymechanisms\\_0.pdf](https://www.ofgem.gov.uk/sites/default/files/docs/2013/02/riioed1decuncertaintymechanisms_0.pdf)

<sup>4</sup> Paragraph 2.6 of the [PSUP Consultation Document](#)

1.7.1 Section 1: Detailed Analysis of NPgN’s proposed adjustments

- This section sets out our assessment of and minded-to position for NPgN’s Enhanced Physical Site Security Costs submission. These are our current views, which are subject to consideration of consultation responses.

1.7.2 Section 2: Detailed Analysis of NPgY’s proposed adjustments

- This section sets out our assessment of and minded-to position for NPgY’s Enhanced Physical Site Security Costs submission. These are our current views, which are subject to consideration of consultation responses.

**Next steps**

- 1.8 This consultation will close on Friday 30 August 2019. Please send in your response by emailing us at [RIIO-ED1@ofgem.gov.uk](mailto:RIIO-ED1@ofgem.gov.uk).
- 1.9 In proceeding with a 28-day consultation we welcome engagement from interested stakeholders during the consultation period. We will publish non-confidential responses on our website at [www.ofgem.gov.uk/consultations](http://www.ofgem.gov.uk/consultations).
- 1.10 Our decision will be implemented through the 2019 Annual Iteration Process, which will mean that any adjustment to NPg’s allowed revenues will take place from 2020/2021.

## 2. Approach to assessment

2.1. We have assessed the submissions in accordance with CRC 3F of the Special Licence Conditions and the RIIO-ED1 Price Control Financial Handbook.<sup>5</sup>

### Compliance with the Special Licence Conditions

2.2. Charge Restriction Condition (CRC) 3F of the Special Licence Conditions sets out what constitutes a proposal for a relevant adjustment by the licensee.

2.3. Under CRC 3F.8, the licensee may propose a relevant adjustment to the allowed level of expenditure on specified uncertain cost activities, provided that the proposed change to the level of allowed expenditure:

- is based on information about the actual or forecast level of efficient expenditure on the uncertain cost activity that was either unavailable or did not qualify for inclusion when the licensee's Opening Base Revenue Allowance was derived
- takes account of any relevant adjustments previously determined under CRC 3F
- constitutes a material amount as specified for the licensee (however, due to uncertainty at the time RIIO-ED1 allowances were set, Ofgem removed the materiality threshold for slow-track licensees for the Enhanced Physical Site Security Costs reopener)
- relates to costs incurred or expected to be incurred after 1 April 2015
- constitutes an adjustment to allowed expenditure that (excluding any Time Value of Money Adjustment) cannot be made under the provisions of any other condition of the licence.

2.4. In addition, CRC 3F.9 provides that a proposal must include statements setting out:

- the uncertain cost activities to which the proposal relates
- the changes to the licensee's allowed level of expenditure that are proposed and the Regulatory Years to which those changes relate
- the basis of calculation for the changes to the licensee's allowed level of expenditure.

### Price Control Financial Handbook considerations

2.5. In accordance with the RIIO-ED1 Price Control Financial Handbook, we have also assessed the proposal to determine whether:

- works that have been carried out, or that are to be carried out, meet the security requirements specified in the relevant recommendation or requirement of the Secretary of State

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<sup>5</sup> ED1 Price Control Financial Handbook (slow track):  
[https://www.ofgem.gov.uk/system/files/docs/2017/08/ed1\\_handbook\\_v3\\_slowtrack\\_0.pdf](https://www.ofgem.gov.uk/system/files/docs/2017/08/ed1_handbook_v3_slowtrack_0.pdf)

- works that have been carried out, or that are to be carried out, represent an efficient level of expenditure.

2.6. We have then reached a minded to position in relation to rejection, acceptance or amendment of the relevant adjustment proposed by the licensee.

### **Informal consultation**

2.7. On 7 June 2019, we published an informal consultation seeking early views on all the ED1 reopener submissions received in the May 2019 window.<sup>6</sup> This informal consultation closed on 21 June 2019.

2.8. We received five responses, one of which responded specifically to NPg’s proposal for an adjustment to allowances for Enhanced Physical Site Security Costs. We have taken this and other relevant factors into consideration in our assessment of NPg’s proposal, and have published this response alongside this consultation.<sup>7</sup>

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<sup>6</sup> Informal consultation on RIIO-ED1 price control reopeners (May 2019): <https://www.ofgem.gov.uk/publications-and-updates/informal-consultation-riio-ed1-price-control-reopeners-may-2019>

<sup>7</sup> <https://www.ofgem.gov.uk/publications-and-updates/decision-our-informal-consultation-riio-ed1-price-control-reopeners-may-2019>



## 3. NPg (NPgN and NPgY) Enhanced Physical Site Security Costs

### Chapter summary

This chapter sets out our assessment and minded-to position for NPg's Enhanced Physical Site Security Costs submission. These are our current views, which are subject to consideration of consultation responses.

### Application

- 3.1. NPg is seeking an increase to allowances of £3.01m in order to fund the cost of upgrading security at five sites designated by CPNI as requiring enhanced security. These sites have been identified as needing protection since ED1 allowances were set in 2014. NPg is requesting £0.92m for its Northeast licensee (NPgN) and £2.09m for its Yorkshire licensee (NPgY).
- 3.2. NPg, on behalf of both NPgN and NPgY, gave Notice of a proposed relevant adjustment during the Enhanced Physical Site Security Costs reopener submission window, which ran from 1 May to 31 May 2019.

### Informal consultation responses

- 3.3. We published an informal consultation on 7 June 2019, seeking early views on submissions received in the May 2019 window. We received five responses, one of which responded specifically regarding NPg's application for an adjustment to allowances for Enhanced Physical Site Security. This respondent was Citizens Advice.
- 3.4. In their response, Citizens Advice argued that the 'Evidence of value for money' section of the reopener submission would benefit from further information and evidence, particularly on the tendering process and the re-using of equipment.

### Our assessment

#### Section 1: Detailed analysis of NPgN's proposed adjustments

##### Compliance with CRC 3F

- 3.5. We consider that in NPgN's application, NPgN has demonstrated that it complies with all of the requirements in CRC 3F and we are satisfied that NPgN's proposed change to the level of allowed expenditure:
  - is based on information about the actual or forecast level of efficient expenditure on the uncertain cost activity that was either unavailable or did not qualify for inclusion when its Opening Base Revenue Allowance was derived
  - takes account of any relevant adjustments previously determined under CRC 3F
  - relates to costs incurred or expected to be incurred after 1 April 2015

- constitutes an adjustment to allowed expenditure that (excluding any Time Value of Money Adjustment) cannot be made under the provisions of any other condition of the licence
- includes statements setting out:
  - the uncertain cost activities to which the proposal relates
  - the changes to NPgN’s allowed level of expenditure that are proposed and the Regulatory Years to which those changes relate
  - the basis of calculation for the changes to NPgN’s allowed level of expenditure.

Price Control Financial Handbook considerations: relevant Secretary of State recommendation or requirement

3.6. Following our assessment, we are satisfied that the works carried out by NPgN match those set out in their CPNI-approved security strategy. As such, they meet the security requirements specified in the recommendation of the Secretary of State.

Price Control Financial Handbook considerations: cost efficiency assessment

3.7. NPgN is seeking an increase to allowances of £0.92m for the project and project management costs associated with implementing the Physical Security Upgrade Programme at two sites. We are proposing to allow £0.88m of these costs. The proposed adjustment to NPgN’s allowances is set out in Table 1 below.

**Table 1. Proposed adjustment to total allowance by site (12/13 prices)**

	<i>Ofgem proposed adjustment</i>	<i>NPgN’s submission</i>
	<i>£m</i>	<i>£m</i>
Site 4 project costs	0.76	0.78
Site 5 project costs	0.08	0.08
Project management costs	0.04	0.06

3.8. We have included a more detailed breakdown of costs in the remainder of this section. Please note that where the sum of the yearly totals does not match the overall total, this is due to rounding.

**Project costs**

3.9. We are minded to amend the project costs that NPgN has submitted to us. This follows a review of NPgN’s submission to determine costs and further discussions with the DNO to discuss the rationale behind these costs. The proposed adjustment to NPgN’s allowances for project costs is set out in Table 2 below.

3.10. NPgN’s submission proposes an increase to allowances of £0.86m for the project costs relating to two sites. While we acknowledge Citizens Advice’s concerns on the ‘Evidence of Value for Money’ section of the submission, we consider that, following our assessment, NPgN has justified all cost areas. However, due to minor differences in calculation approach, we propose to amend the project costs to £0.85m.

**Table 2. Proposed adjustment to allowances for project costs (12/13 prices)**

	2015/ 16	2016/ 17	2017/ 18	2018/ 19	2019/ 20	2020/ 21	2021/ 22	2022/ 23	RIIO- ED1 total
Costs (£m)	0	0	0	0.04	0.8	0	0	0	0.85

### Project management costs

3.11. We are minded to amend the costs for project management that NPgN has submitted to us. This follows a review of NPgN’s submission to determine costs and further discussions with it to discuss the rationale behind these costs. The proposed adjustment to NPgN’s allowances for project management costs is set out in Table 3 below.

3.12. NPgN’s submission pro-rates total project management costs across sites according to the proportion of total costs spent on the sites in question. It proposes an increase in allowances of £0.06m for project management, which makes up 6% of total costs incurred. Following our assessment, NPgN has justified its 2018/19 and 2019/20 costs and we consider that they are reasonable.

3.13. However, we do not consider that NPgN has demonstrated that project management costs incurred from 2015/16 through to 2017/18 were related to the two sites for which it has requested funding. Therefore, we propose to disallow the costs for this period and amend the project management costs to £0.04m.

**Table 3. Proposed adjustment to allowances for Project Management costs (12/13 prices)**

	2015/1 6	2016/1 7	2017/1 8	2018/1 9	2019/2 0	2020/2 1	2021/2 2	2022/2 3	RIIO- ED1 total
Costs (£m)	0	0	0	0.01	0.02	0	0	0	0.04

### Proposed adjustment

3.14. Following our assessment, we therefore propose a total adjustment of £0.88m as opposed to the £0.92m requested by NPgN (an overall difference of £0.04m less than requested), for the period of 2018/19 to 2019/20. This is detailed in Table 4 below.

**Table 4. Total proposed adjustment (12/13 prices)**

	<i>Ofgem proposed adjustment</i>	<i>DNO's submission</i>	<i>Difference</i>
	<i>£m</i>	<i>£m</i>	<i>£m</i>
Costs	0.88	0.92	0.04

**Do you agree with our assessment and our proposal to amend NPgN's request for an adjustment?**

## **Section 2: Detailed Analysis of NPgY's proposed adjustments**

### Compliance with CRC 3F

3.15. We consider that in NPgY's application, NPgY has demonstrated that it complies with all of the requirements in CRC 3F and we are satisfied that NPgY's proposed change to the level of allowed expenditure:

- is based on information about the actual or forecast level of efficient expenditure on the uncertain cost activity that was either unavailable or did not qualify for inclusion when its Opening Base Revenue Allowance was derived
- takes account of any relevant adjustments previously determined under CRC 3F
- relates to costs incurred or expected to be incurred after 1 April 2015
- constitutes an adjustment to allowed expenditure that (excluding any Time Value of Money Adjustment) cannot be made under the provisions of any other condition of the licence
- includes statements setting out:
  - the uncertain cost activities to which the proposal relates
  - the changes to NPgY's allowed level of expenditure that are proposed and the Regulatory Years to which those changes relate
  - the basis of calculation for the changes to NPgY's allowed level of expenditure.

### Price Control Financial Handbook considerations: relevant Secretary of State recommendation or requirement

3.16. Following our assessment, we are satisfied that the works carried out by NPgY match those set out in their CPNI-approved security strategy. As such, they meet the security requirements specified in the recommendation of the Secretary of State.

### Price Control Financial Handbook considerations: cost efficiency assessment

3.17. NPgY is seeking an increase to allowances of £2.09m for the project and project management costs associated with enhancing the physical security of three sites. We are proposing to allow £2.06m of these costs. The proposed adjustment to NPgY's allowances is set out in Table 5 below.

**Table 5. Proposed adjustment to total allowance by site (12/13 prices)**

	<i>Ofgem proposed adjustment</i>	<i>NPgY's submission</i>
	<i>£m</i>	<i>£m</i>
Site 1 project costs	0.64	0.64
Site 2 project costs	0.37	0.37
Site 3 project costs	0.93	0.93
Project management costs	0.13	0.15
<b>Total</b>	<b>2.06</b>	<b>2.09</b>

3.18. We have included a more detailed breakdown of costs in the remainder of this section. Please note that where the sum of the yearly totals does not match the overall total, this is due to rounding.

### **Project costs**

3.19. We are minded to accept the project costs that NPgY has submitted to us. This follows a review of NPgY's submission to determine costs and further discussions with the DNO to discuss the rationale behind these costs. The proposed adjustment to NPgY's allowances for project costs is set out in Table 6 below.

3.20. NPgY's submission proposes an increase to allowances of £1.94m for three sites. We acknowledge Citizens Advice's concerns on the 'Evidence of Value for Money' section of the submission. However, following our assessment, we consider that NPgY has justified all actual and forecast costs and we do not propose to make any amendment.

**Table 6. Proposed adjustment to allowances for project costs (12/13 prices)**

	2015/16	2016/17	2017/18	2018/19	2019/20	2020/21	2021/22	2022/23	RIIO-ED1 total
Costs	0	0	0.02	0.1	1.8	0.01	0.01	0.01	1.94

### **Project management costs**

3.21. We are minded to amend the costs for project management that NPgY has submitted to us. This follows a review of NPgY's submission to determine costs and further discussions with it to discuss the rationale behind these costs. The proposed adjustment to NPgY's allowances for project management costs is set out in Table 7 below.

3.22. NPgY's submission pro-rates total project management costs across sites according to the proportion of total costs spent on the sites in question. It proposes an increase to allowances of £0.15m for project management, which makes up 7% of total costs incurred. Following our assessment, NPgY has justified its costs from 2017/18 through to 2019/20 costs and we consider that they are reasonable.

3.23. However, we do not consider that it has shown that project management costs incurred from 2015/16 through to 2016/17 were related to the three sites for which it has requested funding. Therefore, we propose to disallow the costs for this period and reduce the project management costs to £0.13m.

**Table 7. Proposed adjustment to allowances for Project Management costs (12/13 prices)**

	2015/16	2016/17	2017/18	2018/19	2019/20	2020/21	2021/22	2022/23	RIIO-ED1 total
Costs	0	0	0.04	0.04	0.05	0	0	0	0.13

### Proposed adjustment

Following our assessment, we therefore propose a total adjustment of £2.06m as opposed to £2.09m requested by NPgY (an overall difference of £0.03m less than requested), for the period of 2017/18 to 2022/23. This is detailed in Table 8 below.

**Table 8. Total proposed adjustment (12/13 prices)**

	<i>Ofgem proposed adjustment</i>	<i>DNO's submission</i>	<i>Difference</i>
	<i>£m</i>	<i>£m</i>	<i>£m</i>
Costs	2.06	2.09	0.03

**Do you agree with our assessment and our proposal to amend NPgY's request for an adjustment?**

## Appendices

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## Appendix 1 – Feedback on this consultation

1.1. We want to hear from anyone interested in this consultation.

1.2. Please send your response to the person or team named on this document's front page. 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 <https://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 by clearly marking it confidential and providing reasons. We'll respect this, subject to obligations to disclose information, for example, under the Freedom of Information Act 2000 or the Environmental Information Regulations 2004.

1.5. However, we would like to publish as much of your response as we can. To help us achieve this goal we would appreciate it if confidential material could be provided in a separate appendix to your response. This should also be clearly marked and reasons provided.

1.6. If the information you give in your response contains personal data under the General Data Protection Regulations 2016/379 (GDPR) or domestic legislation on data protection, the Gas and Electricity Markets Authority will be the data controller. 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.<sup>8</sup>

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<sup>8</sup> <https://www.ofgem.gov.uk/consultations/our-consultation-policy>