



ED1 street works reopener response

NORTHERN POWERGRID'S KEY POINTS

- Ofgem has not appropriately evaluated Northern Powergrid's submissions and as a result has reached an incorrect conclusion on its efficient costs allowance.
- Ofgem is wrong in law to refuse to consider Northern Powergrid's second submission.
- Ofgem's benchmarking methodology for Northern Powergrid is irrational and discriminatory.
 - It is manifestly evident that Northern Powergrid will incur permit condition and administration costs and these costs therefore should not be set at zero on any approach.
 - Ofgem has still estimated costs, and made allowances, for other licensees which provided data containing "inconsistencies".
 - Ofgem's calculations show that other licensees have unit costs that are more variable over time than Northern Powergrid Yorkshire's.
 - Ofgem's calculations show that other licensees have unit costs that are more variable relative to Ofgem's benchmarks than Northern Powergrid's.
 - Other licensees revised their data after submission yet, unlike Northern Powergrid, were not excluded from Ofgem's standard benchmarking methodology.
- There are good reasons for variability in Northern Powergrid's unit costs.
 - Northern Powergrid Yorkshire has faced schemes focussed only on the traffic sensitive parts of its road network.
 - Northern Powergrid Northeast has faced only one permit scheme for the majority of the period.
- There is an efficient level of permit variation and penalties.
 - It would be disproportionately costly to avoid variations altogether, therefore it is efficient to incur some level of costs.
 - The same principles apply to penalties.
 - The licence does not prevent DNOs from receiving a reopener allowance for efficient permit variation or penalty costs.
 - Ofgem has previously recognised an efficient level of permit variation and penalty costs.
- Licensees should be able to recover lane rental costs which they are likely to incur during the price control period.
- Both of Northern Powergrid's licensees meet the thresholds when their costs are properly assessed.

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Introduction

1. This is Northern Powergrid's response to Ofgem's consultation for the ED1 street works reopener that was published on 2 August 2019 ("the Consultation").
2. On 12 August 2019 Ofgem provided a copy of its formulae (excluding input data) but it was not until 13 August that Ofgem provided its calculated unit costs and 15 August that it provided a copy all the relevant input information.¹
3. While Ofgem states that the Consultation represents its "initial view" on the reopener outcome we note that the financial handbook describes it as a "provisional determination". We have responded to it as such.
4. The Consultation is entirely open so we have structured our response according to the following areas of significant issue:
 - a. discounting Northern Powergrid's second submission;
 - b. applying a discriminatory special benchmarking methodology to Northern Powergrid;
 - c. failing to estimate efficient costs when Ofgem has all the necessary data;
 - d. failing to recognise that some level of variations or penalties is efficient;
 - e. departing from past regulatory practice of estimating the efficient level of variations and penalties ; and
 - f. failing to allow licensees to recover costs where that licensee has not recorded 12 months of data.
5. The stated purpose of the SSWC reopener is to "allow for changes in revenue arising from legislation related to street works"², i.e. assessing costs that Ofgem considered it was in principle legitimate for DNOs to recover but which could not be accurately costed during the ED1 review, and allowing DNOs adjustments to their allowances based on an efficient costs assessment.
6. We consider that, for the reasons set out in this response, Ofgem has not appropriately evaluated Northern Powergrid's submissions and as a result has reached an incorrect conclusion on its efficient costs allowance. Ofgem should therefore re-evaluate Northern Powergrid's proposed allowance submissions on a proper basis.

¹ Given the date on which the calculations and unit costs were provided, which are critical to an informed understanding of the matters being consulted on, it is questionable whether Ofgem has followed the licence handbook procedure requiring (at least) a 28 day consultation period.

² 2013 ED1 Strategy Decision document, p13.

Ofgem is wrong to discount Northern Powergrid's second submission

7. Ofgem states in the Consultation that:

"NPg provided a 'resubmitted Notice' of its proposal for relevant adjustments, increasing its overall request by £1.0m... CRC 3F.13 is not an opportunity for a licensee to re-submit its proposal. We therefore cannot consider NPg's 'resubmitted Notice'.³

8. There are four reasons that Ofgem is wrong to take this approach in its provisional determination:

- a. the second submission was made while the reopener window was open;
- b. Ofgem has in fact taken some of the information it contained into account;
- c. other licensees were allowed to re-submit their data; and
- d. it is good regulatory practice to use the best available data.

Northern Powergrid's made its second submission while the reopener window was open

9. Under the terms of the licence, a proposed relevant adjustment may be made during the time at which the reopener application window is open.⁴

10. CRC 3F.13 states that:

"If, within 10 working days of receipt of a proposal under paragraph 3F.8, the Authority gives Notice to the licensee:

(a) specifying any further information or analysis, or reformatting of the information or analysis already provided, that it reasonably considers is required in order to assess the proposal; and

(b) requesting the licensee to provide that further or reformatted information or analysis,

the application window will be treated as remaining open for the purposes of this Part A until the later of the closing date referred to in paragraph 3F.10 and the date on which such further or reformatted information or analysis is provided." (emphasis added)

11. There is nothing in CRC 3F stating that revised proposals will not be considered. If a window is stated to still be open, a revised proposal can therefore be submitted.
12. Ofgem sent a request for information ("RFI") to Northern Powergrid within 10 working days of Northern Powergrid's initial notice, and it explicitly noted that *"the application window will be*

³ The Consultation, paragraph 7.3.

⁴ CRC 3F.10.

treated as remaining open until the additional information requested by this Notice has been provided". Northern Powergrid's RFI response and its resubmitted notice were submitted on 21 June 2019. In an email of 26 June 2019, Ofgem confirmed that "on review of [NPg's] responses, we are satisfied that NPg have answered our supplementary questions and therefore consider the application window to be closed".

13. As the application window was still open when Northern Powergrid submitted its resubmitted notice alongside the response to the RFI, Ofgem should have taken into account the duly submitted resubmitted notice when making its determination under CRC 3F.12.

Ofgem has actually taken the information into account in aspects of its provisional determination

14. Although Ofgem states that it "cannot consider" the resubmitted notice, the Consultation makes explicit that it has, in fact, had regard to it, since Ofgem uses the information in the resubmitted notice as one of the reasons for it to discount Northern Powergrid's permit condition and administrative costs, when it states that:

"We have not considered the permit condition and administration costs submitted in NPg's duly made submission due to the poor quality of the information provided and our low confidence in the accuracy of these figures...in their 'resubmitted notice', NPg acknowledged that their permit condition and administration costs included errors".⁵

15. The calculation spreadsheet supporting the consultation, published on 15 August 2019, also contains and uses cost data taken from the second submission, using the revised data to calculate the unit costs that Ofgem refers to in its provisional determination. Ofgem only uses the information from the original submission whenever it states the total additional allowances requested by Northern Powergrid.
16. Ofgem is not entitled to rely on the resubmitted notice selectively.

Other licensees were allowed to re-submit their data

17. As well as Ofgem's decision to refuse to take into account the second submission being incorrect, it also appears to be inconsistent with its approach to the revised data of other licensees.
18. In respect of at least one other licensee, Ofgem accepted revisions to data submitted in the licensee's initial submission in response to Ofgem's initial supplementary questions.⁶ Ofgem has not explained why it was willing to accept and consider revised data from the other licensee in response to supplementary questions, while refusing to do so for Northern Powergrid.

⁵ The consultation, paragraph 7.4, final sentence.

⁶ The Consultation, paragraph 5.4.

It is good regulatory practice to use the best available data

19. Ofgem has a duty to have regard to the principles that represent best regulatory practice.
20. Having regard to the best available data represents best regulatory practice.

Ofgem's benchmarks for Northern Powergrid are irrational and discriminatory

21. Ofgem has devised a special benchmarking methodology that it has applied to Northern Powergrid's two licensees which, unlike its calculations for all other licensees, includes setting zero allowances for permit condition and administration costs.
22. Inspecting Ofgem's calculations, the licensee specific approach applied to Northern Powergrid also has a number of other unique features not mentioned in the Consultation; for example it uses licensee specific benchmark unit costs to project future permit fee costs (whereas all other unit cost benchmarks in Ofgem's calculations are multi-company, not company specific).⁷ These differences in approach are not explained and led to inconsistent outcomes.
23. This is well-illustrated by the example of Derbyshire. Ofgem's calculations for ENWL show that it would assess an efficient cost of £48,780 for ENWL working on 8% of Derbyshire's road network. In contrast, it would assess an efficient cost of only £5,374 for Northern Powergrid for working on 18% of Derbyshire's road network.
24. First it is irrational that Ofgem has not taken into account any permit condition and administration costs in its benchmarking methodology because it is manifestly evident that Northern Powergrid will incur condition and administration costs associated with permits.
25. Second, it is discriminatory for Ofgem to apply a special benchmarking methodology to Northern Powergrid because:
 - a. Ofgem has still estimated costs, and made allowances, for other licensees which provided data containing "inconsistencies".
 - b. Ofgem's calculations show that other licensees have unit costs that are more variable over time than Northern Powergrid Yorkshire's.
 - c. Ofgem's calculations show that other licensees have unit costs that are more variable relative to Ofgem's benchmarks than Northern Powergrid's.
 - d. Other licensees revised their data after submission yet were not excluded from the normal benchmarking methodology.
26. We cover each of these points below.

⁷ There are many problems in Ofgem's company specific benchmark calculations for Northern Powergrid. For example, Ofgem benchmarks away the majority of costs based on unit costs from the start of the ED1 period that Ofgem appears to believe are too low (and which have shown a rising trend), which is bound to give an inadequate allowance, and then also deducts permit penalty fees, representing a clear double count. We have not commented further on these flaws, since Ofgem is wrong to have devised this approach in the first place.

It is manifestly evident that Northern Powergrid will incur permit condition and administration costs

27. The effect of Ofgem's refusal to take into consideration permit condition and administration costs is that it takes these costs to be zero when applying the benchmarking methodology to calculate the proposed allowance. This is questionable as a matter of first principles: it is clear that Northern Powergrid (and all other DNOs operating schemes not taken into account at the start of RIIO-ED1) will incur some level of efficient costs for permit conditions and administration. Permit conditions are deliberately designed to require companies to work in different ways to the lowest possible cost approach that they could otherwise take. By definition, additional administration will require higher system or people costs to undertake.
28. Disallowing these costs in their entirety is therefore inconsistent with the objective of the reopener (allowing for efficient costs arising from schemes that could not be taken into account at the start of ED1).
29. Moreover, Ofgem has repeatedly determined that there is an efficient level of administration and permit condition costs that it expects licensees to incur, since it included these costs in:
 - a. its provisional determinations in respect of five other electricity distribution licensees under the ED1 street works reopener;
 - b. its determinations of efficient costs in the GD1 street works reopener, in September 2015 and September 2018; and
 - c. its baseline allowances for slow-track licensees that requested an allowance for these costs during the ED1 price control review.⁸
30. For these reasons it is irrational for Ofgem to assume that Northern Powergrid can somehow incur a zero level of efficient cost in respect of administering permits and meeting their conditions. Further, Ofgem is clearly not meeting the objective of the reopener by disallowing these costs at the outset.

Ofgem has still estimated costs, and made allowances, for other licensees which provided data containing "inconsistencies"

31. Ofgem states that it carried out a "data cleansing" exercise in order to identify which data it could use in calculating its benchmark efficient costs:

"We identified values where there were inconsistencies (eg significant fluctuations in unit costs between years) and removed these from our analysis. Based on our assessment, we identified that ENWL, SPMW and EPN produced consistent unit costs for the first four years of RIIO-ED1"

⁸ Four slow-track licensees requested an allowance for permit condition costs in their ED1 business plan data templates.

32. Ofgem therefore did not include Western Power Distribution's (WPD's) data in its benchmarking exercise because of concerns regarding their unit costs. Yet Ofgem still applied the standard benchmarking methodology to the relevant WPD licensees in order to calculate their efficient costs, and tested these values against the reopener threshold. One of these licensees receives a proposed allowance, in the provisional determination, based on these benchmarks calculated based on unit costs from other companies.
33. It is therefore discriminatory that Ofgem has taken a different approach to Northern Powergrid and no justification has been provided for this.

Ofgem's calculations show that other licensees have unit costs that are more variable over time than Northern Powergrid Yorkshire's

34. Following publication of the Consultation we asked Ofgem to highlight the specific variations over time and relative to other licensees that it referred to in its Consultation. It did not do so but instead highlighted a set of unit costs that it had calculated for Northern Powergrid and for other licensees.
35. However, this data shows that at least one other licensee has more variable data over time. For example the condition unit cost that Ofgem calculated from Scottish Power Manweb's submission data increases six fold between 2015-16 and 2016-17, yet this data is used in Ofgem's benchmark, and Scottish Power Manweb receives an allowance in spite of this fact.
36. Ofgem's approach to Northern Powergrid Yorkshire is therefore discriminatory.
37. To further demonstrate this point we have set out below the variability over time of relevant costs based on the years for which actual submission data, rather than forecast data, is available.⁹ The table below shows the results.

Licensee	Coefficient of variation (rank)			
	Permit fee	Administration	Condition	All costs
ENWL	0.18 (4)	0.17 (6)	0.13 (4)	0.07 (6)
NPgN	0.38 (2)	1.10 (1)	0.44 (2)	0.71 (1)
NPgY	0.23 (3)	0.38 (3)	0.20 (3)	0.33 (3)
SPMW	0.42 (1)	0.48 (2)	0.53 (1)	0.39 (2)
UKPN-EPN	0.07 (6)	0.07 (7)	0.05 (7)	0.03 (7)
WPD-WMID	0.11 (5)	0.27 (5)	0.07 (6)	0.21 (4)
WPD-EMID	0.04 (7)	0.33 (4)	0.10 (5)	0.18 (5)

⁹ We have used the co-efficient of variation, a standard statistical measure of variability which is designed to be unaffected by the absolute level of a series, and is calculated as its standard deviation divided by its mean.

38. As can be seen from the table, Ofgem has calculated unit costs for Scottish Power Manweb that are more variable over time than those for Northern Powergrid Yorkshire.

Ofgem's calculations show that other licensees have unit costs that are more variable relative to Ofgem's benchmarks than Northern Powergrid's

39. Another limb of the reasoning behind Ofgem's provisional determination for Northern Powergrid is that its costs are variable relative to other licensees.
40. There are in fact several licensees that show greater variation relative to the others than Northern Powergrid.
41. The table below shows the variation in unit costs, relative to the simple average across all companies, in the submission data on actual costs that Ofgem provided.

Licensee	Unit cost variation relative to average across all licensees, actual data only (rank, based on absolute percentage)			
	Permit fee	Administration	Condition	All costs
ENWL	+3% (7)	-40% (5)	4% (7)	-24% (7)
NPgN	-40% (3)	-42% (3)	-90% (4)	-48% (2)
NPgY	-68% (1)	-27% (6)	-93% (3)	-45% (3)
SPMW	+15% (6)	-41% (4)	-36% (5)	-27%(4)
UKPN-EPN	+18% (4)	-43% (2)	-19% (6)	-26% (6)
WPD-WMID	+56% (2)	+177% (1)	+141% (1)	+144% (1)
WPD-EMID	+15% (5)	+16% (7)	+93% (2)	+26% (5)

42. As can be seen from the table, WPD WMID has unit costs that are more variable relative to the average than either of Northern Powergrid's licensees. Ofgem's concern is therefore unjustified.

Other licensees revised their data after their first submission yet were not excluded from the normal benchmarking methodology

43. Ofgem has partly justified its decision to not take into account permit condition and administration costs as being based on data errors in Northern Powergrid's original submission but this is disproportionate and discriminatory for the following reasons:
- a. These errors related to high level omissions, rather than errors in the base data, and were swiftly corrected while the reopener window was open, in a fully transparent manner.¹⁰
 - b. Other licensees also revised their data. UKPN EPN revised its forecasts following responses to supplementary questions and Ofgem did not assume the affected costs to be zero because it did so. Instead Ofgem undertook a review of these figures and stated *"Our review of EPN's forecast volumes indicated that these figures were reasonable"*.¹¹

¹⁰ This included permit condition costs incurred by Northern Powergrid Northeast in 2015/16 and 2016/17, which were omitted because we assumed that they would be de-minimis values, but when we subsequently calculated their value they were not, and the shortened hour permit condition costs we forecast Northern Powergrid Northeast and Northern Powergrid Yorkshire will incur in 2019/20, which were omitted because of a formula error in the spreadsheet which compiled the values in the tables in the Notice.

¹¹ The Consultation, page 15, paragraph 5.4. UKPN EPN's revised forecasts in fact have an obvious flaw, since they do not properly account for the increase in permit scheme coverage that licensee has experienced over the ED1 period. They appear to be too low, rather than "reasonable".

There are good reasons for variability in Northern Powergrid's unit costs

44. In giving its reasons for not considering Northern Powergrid's permit conditions and administration costs at all, Ofgem stated that they considered the information to be of poor quality. The reason given to justify this conclusion is that the costs varied over time and varied from the costs of other DNOs. Yet this ignores the fact that such variances have an objective justification, since Northern Powergrid has faced a very different portfolio of schemes (to date) compared to other licensees:
- a. Northern Powergrid Yorkshire has faced schemes focussed **only** on the traffic sensitive parts of its road network.
 - b. Northern Powergrid Northeast has faced only one permit scheme for the majority of the period.
45. Because of these distinct factors, which are both unique by comparison to other DNOs, the unit costs for Northern Powergrid in its actual data are to be expected to vary from those calculated based on licensees with a very different portfolio of schemes. Given that there are objective reasons for variation in data, together with the fact that there are other DNOs with more variable data than Northern Powergrid (as explained in the section above), this is not a justifiable basis on which to discount Northern Powergrid's data.
46. We explain more about the specific features of the schemes faced by these two licensees below.

Northern Powergrid Yorkshire has faced schemes focussed only on the traffic sensitive parts of its road network

47. In Northern Powergrid Yorkshire's case, the schemes which were introduced in 2015 (and indeed the schemes it had prior experience of, introduced in 2012) all had only partial coverage, in the region of 25% of the highway network, and focussed on the most traffic sensitive roads. By contrast, other licensees have faced a mix of schemes which has had much broader coverage, across all roads (whether traffic sensitive or not).
48. The table below demonstrates this by showing the proportion of the schemes faced by each of the relevant licensees, and which are catered to by the reopener¹², which applied to only traffic sensitive roads.

¹² A number of full schemes, and the partial element of a number of schemes which are transitioning to full schemes, are not covered by the reopener. These full schemes are not included in the count underlying these figures.

Licensee	2015/16	2016/17	2017/18	2018/19
NPgY	100%	83%	63%	50%
WPD EMID	67%	33%	23%	20%
ENWL	7%	7%	6%	6%
NPgN	0%	0%	0%	0%
SPMW	0%	0%	0%	0%
WPD WMID	0%	0%	0%	0%
UKPN EPN	0%	0%	0%	0%

49. This means that, compared to other licensees, Northern Powergrid Yorkshire's unit costs can be expected to be disproportionately affected by:
- the frequency and type of conditions imposed on more traffic sensitive roads, which will in general lead to higher condition costs and higher permit fee costs¹³; and
 - variations in the number of permits, and the specific characteristics of the roads these permits are required on, since there is a lower volume of roads across which averaging can occur.
50. The impact that partial schemes can have on unit costs is also borne out by the data for WPD WMID, which the table above shows is the one other licensee to have been materially affected by this type of scheme. The unit costs Ofgem has calculated for it are both (a) relatively high and (b) relatively variable.
51. Given these factors which explain why variations are objectively justifiable, together with the fact that other licensees whose permit condition and administration costs were considered had statistically more variable data (as explained in the section above), it would be irrational for Ofgem to use variations in unit costs, whether over time or relative to other licensees, as a reason to set a zero allowance for Northern Powergrid Yorkshire.
52. Moreover, the difference between the permit schemes currently faced by Northern Powergrid Yorkshire, relative to other DNOs, is extreme; Yorkshire has had no control whatsoever over this difference; and it is manifestly evident that these difference will cause Northern Powergrid Yorkshire to experience higher costs per permit than other licensees.

¹³ And potentially higher administration costs, although under Northern Powergrid's methodology for estimating administration costs this would only be reflected to the extent permit fees are higher.

Northern Powergrid Northeast has faced only one permit scheme for the majority of the period.

53. In Northern Powergrid Northeast's case, its actual costs are (almost entirely) dependent on a single Highway Authority.¹⁴ This is unique compared to other licenses. The table below show how the absolute numbers compare, based on a simple count of whether schemes covered by the reopener were active¹⁵.

	2015/16	2016/17	2017/18	2018/19
ENWL	14	15	16	17
WPD EMID	6	12	13	15
SPMW	10	10	11	12
NPgY	5	6	8	8
UKPN EPN	4	6	7	7
WPD WMID	3	5	5	7
NPgN	1	1	2	2

54. This means that Northern Powergrid Northeast, unlike all other licensees, will be disproportionately affected by:
- the specific manner in which one (or more recently, two) Highway Authority(s) operate their schemes, and the costs that this imposes;
 - the specific topography of the scheme locale, including the balance of traffic sensitive urban roads when compared to more rural or minor roads; and
 - year-to-year variations in the specific characteristics of the roads permits are required on, since there is a lower volume across which averaging can occur.
55. On the first of these points, there will be some inevitable variation between the manners of scheme operation. For example:
- the two highway authorities Northern Powergrid Northeast faces tend to impose fixed penalty notices more frequently than other highway authorities, imposing greater cost. The relevant data is set out at paragraph 69 below.

¹⁴ A second scheme was introduced in January 2018 which partially fell into Northern Powergrid Northeast's distribution services area and which has had some influence on the licensee's costs.

¹⁵ For schemes where the partial element was catered to in the ED1 allowances, but where the scheme is moving to full coverage, these figures only count the scheme once it moves to a full basis and causes a licensee to incur costs that are relevant to the reopener.

- b. In 2016-17 Northern Powergrid entered into discussions with North Tyneside Highway Authority over the extent of Northern Powergrid's qualification for discounts on permit fees, and this delayed payment of many permit fees into the following regulatory year.

- 56. On the second, North Tyneside, the scheme on which almost all of Northern Powergrid's actual data is based, covers the largely urban area between the centre of Newcastle and the coast. It is bisected by the A19 running north to south (which connects the A1 North of Newcastle to Sunderland and Middleborough) and the A1058 (the main road from North Shields into Newcastle). Given the urbanity of the area, Northern Powergrid's network is largely underground (necessitating more disruptive street works), and it is reasonable to expect that there are a greater density of traffic sensitive streets than many other more rural highway authority areas. While there will be other permit schemes that cover urban areas and share these characteristics, Ofgem has calculated its unit costs at the level of individual licensees, and these figures will average over the topography of several permit schemes for every other licensee.
- 57. On the third, this is simply volume. Because of the lower volume of permits in the actual data, compared to other licensees, the unit cost years for this licensee can be heavily influenced by small variations in the number of street works that fall on particularly traffic sensitive roads (and incur the associated more onerous permit conditions). For a specific highway authority, in one year there can be a relatively large number of street works affected by particularly onerous conditions, while in the following year there may be relatively few, which will disproportionately affect the average in the two years, can cause year-to-year variations.
- 58. Given these factors which explain why the variations are objectively justifiable, it would be irrational for Ofgem to use variations in unit costs, whether over time or relative to other licensees, as a reason to set a zero allowance for Northern Powergrid Northeast.

There is an efficient level of permit variation and penalties

59. Ofgem has stated that *“It is our view that permit variations, and the associated cost are inefficient and we therefore propose to disallow funding for them. We would expect all DNOs to avoid or completely minimise permit variation costs”*.¹⁶
60. Ofgem has also provided no allowance for permit penalties, stating that *“Penalty charges do not fall within the definition of SSWC in the RIIO-ED1 licence. We consider these to be an inefficient cost that should not be borne by consumers and DNOs are expected to manage the risk of incurring such costs.”*¹⁷
61. Yet permit variations are an intrinsic part of the scheme imposed by the relevant legislation, while permit penalty costs relate to the fixed penalty notices that the statutory process allows Local Authorities to impose on a routine basis for minor non-compliance where companies are allowed to discharge the notice by payment, not for exceptional transgressions.
62. Ofgem is therefore wrong to refuse to provide an allowance for them, where requested, because:
 - a. It would be disproportionately costly to avoid permit variations altogether, therefore it is efficient to incur some level of variation;
 - b. The same is also true for penalties; all DNOs incur permit penalties in non-negligible numbers, and in fact Northern Powergrid is one of the more “efficient” companies;
 - c. The ED1 licence (and regulatory instructions and guidance, “RIGs”) do not prevent DNOs from receiving a reopener allowance for efficient permit variation or penalty costs; and
 - d. Ofgem previously recognised an efficient level of permit variation and penalty costs.

It would be disproportionately costly to avoid permit variations altogether, therefore it is efficient to incur some level of variation

63. It would not be efficient for a DNO to avoid ever varying permits:
 - a. If DNOs do not vary the permits when their plans change, they will incur, at the minimum, a higher volume of fixed penalty notices and therefore higher costs;
 - b. If DNOs ossify their operational plans at the point of being granted a permit, this would result in a loss of flexibility in deploying resources, and the efficiency

¹⁶ Consultation paragraph 2.17

¹⁷ Consultation paragraph 2.21

costs of forcing this to happen are likely to far exceed the cost of a variation fee; and

- c. The cost of confirming all permit conditions in advance of an application would be prohibitive, for both the Highway Authority and the licensee, while the licensee “volunteering” an excessive list of conditions in its application (to reduce to zero the chances of the Authority requiring a further condition) would inefficiently raise the DNOs condition costs.

64. The question for an economic regulator, which has a duty to ensure a company can finance the costs of meeting its obligations, should be establishing the efficient level of permit penalty and variation costs.

It would be disproportionately costly to avoid penalties altogether, therefore it is efficient to incur some level of penalties

65. It would also not be efficient for a DNO to ever avoid incurring penalties. In order to avoid permit penalties altogether, licensees and their contractors would need to:

- a. devote additional staff time on site to ensuring ongoing compliance with all the requirements of permits, incurring an incremental cost;
- b. invest more in staff training and refresher training on an ongoing basis; and
- c. put in place an audit regime, to ensure ongoing internal compliance, incurring the additional cost of the associated roving audit teams, much more than duplicating the costs incurred by Local Authorities in paying inspectors.

66. Higher permit variation costs would also follow from these steps.

67. Avoiding permit penalties altogether, and not incurring a single penalty, would manifestly be disproportionately costly; the costs of the steps taken to remove the risk of incurring penalty fees would far exceed the penalty costs incurred had those steps not been taken, and Ofgem would be very unlikely to fund these costs. Therefore an efficient licensee will inevitably incur some permit penalties (and benefit from lower penalty avoidance costs as a consequence).

All DNOs incur permit penalties in non-negligible numbers

68. There will instead be an efficient level of permit penalty charge fees that DNOs should achieve; depending on how aggressive the relevant local authorities are in policing the scheme.¹⁸
69. The table below shows the total number of permit penalties incurred by English licensees, as a percentage of total permit volumes, for both reopener and non re-opener permit schemes.

	Permit penalties (% of total permit volumes in ED1 period to date)
Licensee 1	2.5%
Northern Powergrid Yorkshire	2.7%
Licensee 2	3.6%
Licensee 3	3.9%
Licensee 4	4.9%
Licensee 5	5.5%
Licensee 6	6.6%
Licensee 7	7.8%
Northern Powergrid Northeast	8.6%
Licensee 8	11.0%
Median	5.2%

The ED1 licence (and RIGs) do not prevent DNOs from receiving a reopener allowance for efficient permit variations or penalty costs

70. As permit variation costs self-evidently fall within the definition of SSWC (see below) as a “permit fee cost”, there is no reason to exclude DNOs from receiving an allowance for efficient permit variation costs.
71. In respect of penalty charges, Ofgem claims in the Consultation that “Penalty charges do not fall within the definition of SSWC in the RIIO-ED1 licence.”¹⁹ This is not correct. The licence states:

Specified Street Works Costs means the costs incurred, or expected to be incurred, by the licensee in complying with obligations or requirements arising under any order or regulations made under Part 3 of the Traffic Management Act 2004 (or, in Scotland, the Transport (Scotland) Act 2005) that impose a permit scheme, lane rental scheme or equivalent and comprise:

¹⁸ Northern Powergrid Northeast currently only faces two permit schemes, North Tyneside and North Yorkshire. In both cases the administering authority is relatively aggressive in enforcing penalties.

¹⁹ The Consultation, page 9, paragraph 2.21

(a) permit fee costs;

(b) one-off set-up costs;

(c) administrative costs arising from the introduction of permit schemes or equivalent and lane rental schemes or equivalent; and

(d) costs arising from the introduction of permit conditions or equivalent and lane rental schemes or equivalent

all as further clarified in the RIGs. (emphasis added)

72. Penalty fees for failing to meet conditions imposed by permits therefore fall within the scope of the licence definition, as they are “costs incurred...by the licensee in complying with obligations or requirements arising under... a permit scheme”. We could not incur these penalty fees if a permit scheme had not been imposed (and permit variations are included on the same logic).
73. The question is therefore which of the four licence categories penalty fees fall within. This has never been clarified within the RIGs as the licence would allow.²⁰ Instead the RIGs define their own set of terms and reporting categories but the terms are all distinct from those used in the licence and no mapping is provided (in the RIGs or licence) to the licence terms.²¹
74. However, the RIGs definition of “Permit and Lane Rental Administration Costs” does include “*The costs from processing Permit and Lane rental applications and processing the payment of associated penalties*” (emphasis added). Therefore any licensee that has reported its permit administration costs according to RIGs definitions, and requested an allowance based on this data (such as Scottish Power Manweb) has indeed requested some (or all) of the costs associated with permit penalties, and Ofgem has taken no steps to inspect this further.
75. The fact some licensees have chosen to not request (part of) the costs that the licence permitted them to – whether this is because they mis-read the licence, because they wished to avoid a discussion of the efficiency of their permit penalty costs or for any other reason – is not relevant to Ofgem’s assessment of Northern Powergrid’s request.
76. We would also highlight that, in contrast to permit penalty fees, we did not include overstay fines within our reopener claim. This is because we would have incurred these under the prior “noticing” regime, and therefore we expect to incur no additional costs when a permit scheme is introduced.²² Through its ED1 benchmarking, Ofgem has already provided us with an allowance for the efficient level of these overstay fines.

²⁰ Our submission assumed they fall within (a), but they could also fall within (c) or (d).

²¹ In its reopener Notice Scottish Power Manweb attempted to “map” the RIGs terms to the licence. This mapping is spurious as it is not set out in the licence or RIGs, and it is contrary to statements in the licence and RIGs.

²² Our licence special conditions (CRC 3F.8(a)) limits the reopener claim to incremental costs. We have not identified any incremental costs associated with overstay fines, when permit schemes are compared to noticing schemes.

Ofgem has previously recognised an efficient level of permit variation and penalty costs

77. Ofgem has previously recognised that there is an efficient level of permit variations and penalties, and it is inconsistent with past practice for Ofgem now to claim that the efficient level is zero. For example, Ofgem has previously explicitly evaluated:
- a. the efficiency of Cadent's permit variation costs at the GD1 reopener, allowing these costs into Cadent's allowances; and
 - b. an efficient level of permit penalty costs at the ED1 price control review, using this to set allowances.
78. Taking the first of these examples, at the GD1 reopener in 2015 Ofgem explicitly considered permit variations costs. Ofgem was advised by its own external expert as follows:
- "Permit variations will always be necessary, especially where some authorities are more unreasonable than others. I am of the opinion that the Regulator should determine an efficient percentage level."*²³
79. Ofgem subsequently went on to accept Cadent's level of permit variations, after the company had made some revisions to its data, stating *"We accept the revised permit variation volumes for both London and North West."*²⁴
80. Turning to the second example, the ED1 cost benchmarking included an assessment of the efficient cost of permit penalties. In its disaggregated analysis, Ofgem:
- a. calculated a benchmark rate of penalty fees of 3%, as a proportion of permits issued, based on the median rate seen by DNOs that had actual data for (up to) the first four years of the DPCR5 period; and
 - b. coupled this proportion with a unit cost of £80 per penalty from the gas distribution review (although DNO unit costs were higher).

This led to Ofgem setting an efficient benchmark level of cost for DNOs that received upfront allowances. For one licensee (UKPN LPN) this assessment amounted to £3m over the ED1 price control period.

²³ Les Guest associates report for Ofgem, GD1 reopener, 2015, page 1.

²⁴ Ofgem, 2015, GD1 reopener final determination, page 3.

Licensees should be able to recover lane rental costs

81. Scottish Power, WPD and Northern Powergrid all requested allowances for lane rental costs.²⁵ Ofgem has rejected these requests saying that:
- a. none of the schemes have 12 months of data;
 - b. there is “*no certainty*” that schemes will be implemented by 2023 in several cases; and
 - c. there is “*no credible evidence*” to support Northern Powergrid’s request.
82. Ofgem cites the ED1 financial handbook to justify its requirement that a licensee has 12 months of data on lane rental schemes in order to gain an allowance.²⁶
83. Looking at the licence and handbook architecture there is however no statement that Ofgem should not allow costs where a licensee does not have 12 months of data:
- a. the licence contains no rule that the costs must relate to schemes with 12 months of data; instead the only relevant requirement placed on DNO proposals for a reopener is that they must be “*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*” (CRC 3F.8 (a)); and
 - b. the relevant section of the ED1 financial handbook, describing procedures for arriving at determinations, states that the Authority will “*The Authority will check whether... the licensee has provided, or will be able to provide 12 months’ worth of costs data to support its proposal*”.
84. There is no statement as to what Ofgem is to do if it identifies there is not 12 months of data. A sensible approach would be to limit the weight placed on values that are not based on 12 months of data in Ofgem’s benchmarking.
85. Moreover, the licence or handbook does not stipulate that Ofgem needs to check whether a licensee has reported data on its own costs. It merely states that the licensee needs to be able to “*provide 12 months’ worth of costs data to support its proposal*.” Data on lane rental schemes does exist, because of some lane rental schemes implemented in London. We used some of the data from these schemes to support the proposal in our reopener Notice.
86. We are, by definition, facing some probability that lane rental schemes will be implemented ahead of April 2023 in the regions we face. By definition, the costs can only be positive, and not negative.

²⁵ In Northern Powergrid’s case we requested allowance in the form of volume driver or, failing that, a probability adjusted allowance for lane rental costs. The volume driver is covered in the next sub-section.

²⁶ Consultation, paragraph 2.15

Ofgem's position of zero for its assessment expected efficient costs could only be true if there was *no chance at all* of a scheme being implemented. This is manifestly not the case. Further, if the practical effect of discounting these costs is that there is no way to recover them (despite the fact that they will be incurred within the price control period), this cannot be the correct conclusion. This would be at odds with fact that the purpose of the reopener mechanism is to allow adjustments to be made to the allowed expenditure to more accurately reflect the costs actually incurred or expected to be incurred over the whole of the price control period.

Ofgem must now evaluate Northern Powergrid's efficient costs

87. Having failed to do so in its provisional determination, Ofgem must now determine an efficient level of cost for Northern Powergrid because:
- a. setting zero allowances because it considers the data to be variable is irrational and a disproportionate and discriminatory response; and
 - b. the financial handbook procedure (and licence) requires Ofgem to obtain further information where it cannot make a determination.

Setting zero allowance is irrational, and a disproportionate and discriminatory response

88. Ofgem's decision for Northern Powergrid, on which £15.5m in allowances for permit costs depends, hangs primarily on Ofgem's view that it identified certain variations in Northern Powergrid's data (over time and relative to other licensees) and, because Northern Powergrid corrected some discrete omissions in its first submission, this data should be disregarded.
89. Ofgem has responded by applying a punitive methodology that ensures the company will fall well short of the reopener thresholds, and, as a consequence, will receive no cost allowances for the relevant activity. This is, in effect, a £15.5m "penalty" which is entirely disproportionate. This response also sends entirely the wrong regulatory incentives, by punishing a company for correcting a data submission.
90. Any variation in unit costs relative to other licensees does not justify applying a punitive benchmarking methodology. If the variation is explained, justifiable, and outside of company control, it would support allowing the company its actual costs. If the variation is unexplained, or depends on company decisions more than on external factors, it justifies a cross-company benchmarking approach to determine an efficient level of costs. This is an approach Ofgem is familiar with as it uses it to determine the vast majority of cost allowances across sectors and price controls, and has done so since privatisation.
91. Moreover, the approach Ofgem is proposing to use would lead to an irrational outcome. It is clear that some level of efficient costs will be incurred by Northern Powergrid, so to set permit condition and administration costs (which together make up the majority of the requested allowance) at zero, which has the knock on effect of resulting in no cost allowances at all, is clearly an irrational position which is at odds with the objective of the reopener. Provision should also be made for costs associated with variation, penalties, and lane rental.
92. Ofgem has also not been consistent in its treatment of Northern Powergrid compared to other DNOs. It applied a unique and discriminatory benchmarking methodology to Northern Powergrid, without adequate justification or explanation, and allowed other DNOs to revise data in response to supplementary questions when it did not do the same for Northern Powergrid.

93. Finally, Ofgem's response is also based on an error of law, to the extent that it derives from its incorrect reading of CRC 3F.13. It is clear that, as the application window was still open by virtue of that provision (and Ofgem had explicitly confirmed that fact), Northern Powergrid was entitled to submit its revised proposed adjustment. As a result, Ofgem's decision to refuse to consider the revised adjustment amounts was wrong.

The financial handbook procedure (and licence) requires Ofgem to obtain the information it needs to make a determination

94. The licence states that:

"the Authority will, within four months of the close of the application window, determine any revisions that are to be made to the licensee's allowed level of expenditure for the uncertain cost activities concerned and the Regulatory Years to which those revisions relate, in accordance with the methodologies set out in the following sections of chapter 7 of the ED1 Price Control Financial Handbook..."²⁷ (emphasis added)

95. The process set out in the financial handbook states that Ofgem needs to identify any additional information it requires, and to request this from the licensee.

"The Authority will decide whether it requires any further information from the licensee in order to make a determination and, if it decides that further information is required, it will give Notice of that requirement to the licensee as specified in paragraph 3F.134 of CRC 3F within 10 working days of receipt of a proposal under paragraph 3F.8 of CRC 3F."

96. Ofgem appears to have decided that it did not have the information required to make a determination for Northern Powergrid in respect of permit condition and administration and costs. Yet it has made no further information requests to try to obtain information (and understand, for example, the "variations" to which it refers in its provisional determination) that would allow it to make a determination.
97. As well as Ofgem's approach being discriminatory (as set out in the proceeding section of this response), Ofgem does not have the option under the financial handbook procedure of simply saying that it does not have the information necessary to calculate an efficient level of certain types of cost.

²⁷ CRC 3F.12

Both of Northern Powergrid's licensees meet the thresholds when their costs are properly assessed

98. Ofgem now has the data necessary to calculate a benchmark allowance for Northern Powergrid.²⁸

If the approach taken for other licensees at the provisional determination had been applied to Northern Powergrid, it would have qualified for its full requested adjustment

99. Indeed, even though Ofgem has chosen to disregard entirely Western Power Distribution's data on costs, it has still estimated an efficient level of costs for two of its licensees in its provisional determination. If Ofgem used the same approach for Northern Powergrid, based on its assessment of Northern Powergrid's efficient volumes²⁹, it would calculate benchmark efficient costs, excluding lane rental, of £7.7m and £12.8m for Northeast and Yorkshire, respectively.

100. In both cases Ofgem would allow Northern Powergrid its full proposed adjustment of £5.7m and £9.7m for its two respective licensees.

A benchmark can be calculated while making no use whatsoever of the cost and volume information provided by Northern Powergrid.

101. Ofgem is also in a position to estimate the cost faced by Northern Powergrid ***while making no use whatsoever of the cost and volume information provided by the company***, and to test Northern Powergrid's submitted costs against this level.

102. In order to do so, Ofgem would need to extend its benchmarking approach to volumes, rather than just unit costs.

²⁸ Ofgem has misinterpreted the data we provided in our application and assumed our reopener claim covers all the permit schemes Northern Powergrid faces. In fact the costs in our application do not include any costs in relation to the roads covered by six partial schemes implemented in June 2012, only the roads that will be newly covered by schemes during the ED1 period. We have included corrected data on Northern Powergrid's reopener schemes in the annex to this response in the format in which Ofgem uses the data in its spreadsheets. We have also provided data on the level of coverage of partial schemes (which Ofgem had not previously requested but had instead assumed to be 50%) in the annex. In respect of the methodology used to calculate the percentage of highway authorities that fall in Northern Powergrid's service areas, we previously informed Ofgem that we had used a methodology that "takes a list of roads in each local authority's area, obtained from the DfT's website, and compared it to a list of roads we have worked on in the last four years, to identify a percentage." However, it has since come to light that the methodology used was to calculate the values as the residual of the values provided by other licensees in some cases or visual inspections of maps in others. This approach was taken due to the lack of availability of the relevant data at the time of the request, and we consider that the data provided on this basis was the best data we could provide at the time and within the set timescale.

²⁹ In the first tab of attachment 3 to Northern Powergrid's response to Ofgem's first information request, Northern Powergrid included total permit volumes for each licensee for all work that is both planned and unplanned.

103. To illustrate this, we have calculated a benchmark level of cost for Northern Powergrid based on:

- a. the number of Highway Authority schemes covered by the re-opener in Northern Powergrid Northeast and Northern Powergrid Yorkshire's service areas;
- b. the average number of permit applications per Highway Authority made by the three licensees Ofgem has based its unit cost benchmark on;
- c. the efficient level of permit variations, that can be estimated as the median from the reopener data, of 16%³⁰ at an estimated cost £40³¹ per variation;
- d. the efficient proportion of permits incurring penalties based on the median seen by DNOs in the ED1 period to date³² (5.2%), and the cost per penalty of £80 used at the ED1 price control review³³; and
- e. a benchmarked, probability adjusted, cost of lane rental schemes, adjusted to Ofgem's assessment of the likelihood of lane rental implementation for Northern Powergrid.

104. Most of these steps are self-explanatory. In respect of steps c. and d., these are made necessary by the fact that Ofgem states in the Consultation that other DNOs, and/or Ofgem's benchmark unit cost, make no allowance for these costs. Since Ofgem is wrong not to allow the efficient level of these costs, for the reasons set out in the sections above (at least in respect of those DNOs that requested that they be allowed), it is necessary to add them in as separate steps.

³⁰ Based on the three DNOs used by Ofgem in calculating its benchmarks.

³¹ The mid-point of Ofgem's "expected range" of £35-£45 in the Ofgem's 2015 GD1 reopener final determination, page 3. To date the charges set by the Highway Authorities Northern Powergrid faces have been £45 but this could fall as more non-sensitive roads are covered by the schemes.

³² The same methodology that Ofgem applied in the ED1 review disaggregated benchmarking, when it used DPCR5 data.

³³ This value would only cover the £80 cost of prompt-payment of a fixed penalty notice for not meeting permit conditions. The cost escalates to £120 for later payment, while fixed penalty notices for working without a permit involve significantly higher charges (£300 or £500 depending on speed of payment).

105. The table below shows the results, set out according to the steps in paragraph 103 above, for both of Northern Powergrid's licensees.

	Northeast	Yorkshire
Benchmarked permit costs (a x b)	£7.2m	£7.0m
Benchmarked permit variation costs (c)	£0.4m	£0.3m
Benchmarked permit penalty costs (d)	£0.2m	£0.2m
Estimated lane rental costs assuming 1% and 2% probabilities in 2021-22 and 2022-23 respectively (e)	£0.2m	£0.2m
Total	£8.0m	£7.8m

Note: Figures do not cast due to rounding

Annex: Additional data

	Full or partial scheme [1]		Transition from partial to full	
	Full	Partial	Full	Partial
Barnsley[2]	100%	21%	Sep-19	Jun-12
Doncaster Met [2,3,4]	100%	5%	Apr-19	Jun-12
Kirklees [2]	100%	13%	Jan-20	Jun-12
Leeds [2]	100%	32%	Jan-20	Jun-12
Rotherham [2]	100%	15%	Oct-19	Jun-12
Sheffield [2]	100%	32%	Jan-20	Jun-12
Lancashire	100%		Mar-15	
Bradford [3]	100%	9%	Jun-19	Mar-15
Calderdale	100%	20%	Jan-20	Mar-15
Derbyshire	100%	23%	Jan-20	Mar-15
Wakefield	100%	24%	Jan-20	Mar-15
North Lincolnshire [3] [4]	100%	17%	Jan-18	Mar-16
Lincolnshire County	100%		Oct-16	
North Yorkshire	100%		Feb-18	
East Riding of Yorkshire	100%		Jan-20	
Hull	100%		Jan-20	
North East Lincolnshire	100%		Jan-20	
Nottinghamshire County	100%		Jan-20	

Notes:

[1] Percentages for partial schemes are based on the proportion of road network for each Highway Authority, in miles, covered by the partial permit scheme.

[2] The costs associated with the roads covered by partial schemes implemented in June 2012 are not included in Northern Powergrid's reopener application.

[3] Partial schemes that have already transitioned to full scheme.

[4] In the time available for this consultation response, we were unable to calculate partial scheme coverage based on road network length for partial schemes that were replaced with full schemes prior to September 2019. For these schemes we have instead provided a value based on a count of the number of roads covered by the permit scheme, measured as a percentage of the current number of roads. We may be able to provide a value based on road length at a later date, if requested.