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Dear Victoria

### **RIIO-ED1 Reopener Consultation – Specified Street Works Costs**

Thank you for the opportunity to respond to the above consultation dated 2 August 2019. This response is sent on behalf of UK Power Networks' three distribution licence holding companies – Eastern Power Networks plc (“**EPN**”), London Power Networks plc (“**LPN**”), and South Eastern Power Networks plc (“**SPN**”). We are the UK's largest electricity Distribution Network Operator (“**DNO**”), dedicated to delivering a safe, secure and sustainable electricity supply to 8.3 million homes and businesses. Our fundamental concern is with Ofgem's minded-to decision with respect to EPN's proposal for an adjustment to allowances in respect to Specified Street Works Costs.

The RIIO framework has proven to be successful in driving significant performance improvements in the electricity system, and therefore benefits customers through higher quality of service and lower bills. The RIIO arrangements for dealing with areas which are uncertain at the time of setting price controls play an important part in managing the risk between customers and companies. For the RIIO framework to succeed, it is important that when the areas of uncertainty fall to be clarified (as here with street works costs) the relevant mechanisms are operated reasonably, consistently and transparently.

With the above in mind, we strongly disagree with the following aspects of Ofgem's minded-to decision, which we invite Ofgem to reconsider:

#### **A. The 3% efficiency assumption for forecast costs**

Ofgem's minded-to decision applies an across-the-board 3% annual efficiency reduction to the forecast costs for the remaining four years of the RIIO-ED1 price control.

#### **No explanation of 3%:**

No quantified justification has been given for the figure of 3%, or for applying it every year – it appears to be an arbitrary assumption.

## **Not in line with approach taken for setting the RIIO-ED1 price control**

When setting allowances for the RIIO-ED1 price control, DNOs put forward ongoing efficiencies reflecting the category of work being proposed. These efficiency assumptions varied between 0.63% and 1.02% per annum depending on the area of work. Based on the split of the street works costs in the EPN licence area, a blended efficiency rate of 0.93% would apply to the costs that we put forward in our street works reopener submission<sup>1</sup>. Ofgem accepted these ongoing efficiencies as part of the Final Determination of allowances for the RIIO-ED1 period<sup>2</sup> and have given no evidence as to why higher efficiencies should be applied for the purposes of this reopener. Ofgem should use the evidence-based values used in the price control settlement rather than an arbitrary figure, which has no quantified justification or assessment of achievability, when making any adjustments for efficiency in this reopener.

## **No evidence of level of efficiency included in Ofgem analysis:**

Companies have an incentive to implement efficiencies, so the observed historic rate of change is informative. Ofgem's analysis for this reopener includes annual unit costs for companies over the RIIO-ED1 period for each of the elements that constitute Street Works expenditure. Even for the companies that are considered to have reliable data, there is no evidence in this dataset of consistent efficiencies across the cost elements. For an efficiency level to be set and applied we would expect to see evidence of how it was calculated and how it is expected to be achieved over the remaining four years of RIIO-ED1.

## **Inconsistency with gas distribution:**

Ofgem suggests that its approach is consistent with that taken for previous street works reopeners in the gas distribution sector. That in itself is not a good justification, unless the gas distribution decision was properly reasoned. In any event, it is factually incorrect. Although a 3% efficiency reduction was applied to the gas distribution reopener in 2015, a 3% efficiency assumption was applied only to Administration Costs in the more recent 2018 gas distribution reopener. The original application of 3% in 2015 was queried by National Grid Gas at the time and the limited application in 2018 shows that Ofgem recognises that 3% is not universally applicable.

## **Failure to account for differing levels of maturity:**

The 3% has been applied across the board to all companies, irrespective of the fact that some DNOs are at different levels of maturity in dealing with street works permitting schemes. Applying the same figure to all is therefore discriminatory – it is not acknowledging the efficiencies already realised by UK Power Networks. Highways Authorities within UK Power Networks' licence areas have been operating permitting schemes for a longer period. Indeed, the first permit scheme to go live was the London Permit Scheme (LoPS) in January 2010. We have had nine years to embed processes across our three licence areas and have already achieved significant improvements in our processes and consequent efficiencies. EPN is already operating at a greater level of efficiency than other DNOs as evidenced by the fact that it saw the lowest relative adjustment in Ofgem's assessment of proposals when taking account of unit costs and volumes.

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<sup>1</sup> See Appendix 2 for calculations used to derive this value

<sup>2</sup> [https://www.ofgem.gov.uk/sites/default/files/docs/2014/11/riio-ed1\\_final\\_determination\\_expenditure\\_assessment\\_0.pdf](https://www.ofgem.gov.uk/sites/default/files/docs/2014/11/riio-ed1_final_determination_expenditure_assessment_0.pdf)  
see paragraph 12.50

## **B. Benchmarking**

We disagree with the following aspects of the benchmarking which Ofgem carried out in order to inform its view of efficient unit costs:

### **Deviation from policy used in setting RIIO-ED1 price control allowances**

In setting the allowances for the RIIO-ED1 price control, Ofgem carried out a separate assessment of street works costs. In the RIIO-ED1 Final Determination<sup>3</sup>, Ofgem set out their positions on how the costs were assessed and the justification for these decisions. It is clearly stated in this document that:

*“As permit volumes and costs are specific to particular local authorities and highway authorities, industry benchmarking was not appropriate.”*

Additionally the Final Determination states:

*“We accept that permit condition costs are bespoke to each local authority or highway authority and therefore need to be justified on a case-by-case basis... This approach accepts that each DNO may incur different costs due to different conditions imposed on them but also recognises that its area that is difficult to benchmark and data is volatile.”*

Ofgem have not provided a reason for why these same principles do not apply to the street works costs being assessed under this reopener. Unless demonstrable evidence can be provided as to why the circumstances have materially changed since setting allowances in 2014, Ofgem should not be using benchmarking to determine the efficient costs of an individual DNO.

### **Cherry-picking of benchmarking data:**

Notwithstanding the point above regarding the applicability of benchmarking to an individual DNO's costs, Ofgem's benchmarking exercise did not use all available robust unit cost data – specifically, it did not use the data from LPN and SPN. This is despite the fact that, as a result of the high quality evidence provided at the RIIO-ED1 price control, both LPN and SPN were given ex-ante allowances for street works costs for RIIO-ED1. That is why it was not necessary for UK Power Networks to submit reopener claims for LPN or SPN. Nevertheless, we have throughout RIIO-ED1 submitted data to Ofgem via the annual Regulatory Reporting Packs for all three of our distribution licensees. Additionally, as part of Ofgem's street works reopener assessment we provided additional information, as requested by Ofgem, for both LPN and SPN. Ofgem gives no explanation in its minded-to decision as to why it has ignored this valuable and important data source from LPN and SPN. Excluding such data from the benchmarking risks the result not being representative of the full picture across Great Britain. LPN's activities are a good comparator for EPN, as the latter's network includes a large part of North London similar in nature to LPN's network in that it covers a dense urban area with many traffic-sensitive roads.

An analysis of the data available to Ofgem at the time of conducting its reopener assessment indicates that, of the £14m<sup>4</sup> reported on street works in RIIO-ED1 to date, LPN and SPN account for 30% of this combined national expenditure. This further illustrates the materiality of failing to include this information in the benchmarking assessment.

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<sup>3</sup> [https://www.ofgem.gov.uk/sites/default/files/docs/2014/11/riio-ed1\\_final\\_determination\\_expenditure\\_assessment\\_0.pdf](https://www.ofgem.gov.uk/sites/default/files/docs/2014/11/riio-ed1_final_determination_expenditure_assessment_0.pdf)

<sup>4</sup> Where data available through RRP submissions

## **Failure to follow the process announced in the RIIO-ED1 Strategy Decision**

Whilst Ofgem's approach to assessing street works costs from DNOs evolved over the course of the RIIO-ED1 price review, culminating in the approach outlined above, Ofgem's approach to the 2019 street works reopener applications fails to even follow the approach originally specified in the RIIO-ED1 Strategy Decision from 2013. This indicates that the comparative assessment will use a much wider set of data, where available, including data provided by other network companies and data from other sectors.<sup>5</sup> The narrow approach taken in this reopener assessment does not do this.

The Strategy Decision further indicates that such comparative benchmarking will be used only for "*one-off set up costs, additional administration costs and the impact of any permit conditions*". Despite this, the comparative assessment used for this reopener has been used to calculate Ofgem's view of efficient unit costs for all areas of expenditure including permit fees. We consider this to be wholly inconsistent with the process in the Strategy Decision.

### **Ex-post efficiency assessment**

Benchmark unit costs have been applied to reduce actual costs for the first four years of RIIO-ED1. This is an unacceptable ex-post efficiency adjustment because it has been applied without any evidence that the costs were incurred inefficiently.

### **C. Forecast Volumes**

EPN's original proposal under CRC 3F included a forecast of volumes for the remaining four years of RIIO-ED1 which was based on data for the latest available year (2018/19). We took that approach because 2018/19 was the first year in which all permitting schemes were operational for a full 12 months.

However, as a result of subsequent supplementary questions from Ofgem, we identified that the volumes in 2018/19 had increased due to combination of further permitting schemes being operational as well as an underlying increase in volumes of work and it would be wrong to include that atypical increase in relevant work in the forecast (as per the Strategy Decision). In the very short period we had to respond to the supplementary questions from Ofgem (five working days), we took the simple approach of revising our forecast volume figures by basing them instead on an average of the first four years of RIIO-ED1.

On reflection, with the luxury of time, we have identified a fundamental flaw in our revised figures. Our revised approach of taking an average of the first four years of RIIO-ED1 resulted in the inclusion of volumes for years in which some permitting schemes were not operational. The result is to artificially suppress the forecast of future volumes, now that all permitting schemes are operational.

We have therefore carried out further analysis, taking an average for schemes only for the years in which they were fully operational, essentially removing the "zeros" from the average. This revised average is still over the first four years of RIIO-ED1 for schemes that were operational for this full period and presents a more robust and accurate view of expected volumes in the remaining years without being unduly impacted by the rise in work volumes seen in 2018/19. We provide further details of the calculation of this average in Appendix 1 and request that this more accurate view of forecast volumes is used in Ofgem's analysis in its final decision. We do not believe it is controversial for Ofgem to revise figures between minded-to and final decision but if any reference to precedent is needed, see the decision from the 2015 Gas Distribution reopener in which Ofgem took account of information provided by National Grid Gas Distribution which was provided after

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<sup>5</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) See para. 3.21.



Ofgem's minded to decision. The information provided was accepted by Ofgem and resulted in a revised figure in the Final Decision.<sup>6</sup>

#### **D. Process**

We also note that the process following Ofgem's minded-to decision has been frustrated by the fragmented release of information fundamental to the assessment of the reopener. This initial lack of information impaired our ability to properly consider Ofgem's decision and formulate our subsequent response. This has been coupled with the most recent time extension where Ofgem has sought to ensure a 28 day period has been afforded to licensees and stakeholders as per the original consultation deadline. We therefore, question whether moving the due date multiple times, in one case with several hours' notice, represents an adequate process.

#### **Summary**

Taking into account the information above, we have set out below a summary of how this influences the assessment of EPN's proposal under this reopener. This is based on the assumption of using the average EPN unit cost with a 0.93% efficiency applied to the remaining years of RIIO-ED1 and the revised volumes explained above.

	2016	2017	2018	2019	2020	2021	2022	2023	RIIO-ED1
Volumes (#)	7,451	8,454	8,842	10,219	9,357	9,357	9,357	9,357	72,395
Unit cost (£)	141.92	148.48	141.79	150.41	144.30	142.96	141.63	140.32	143.97
Total cost (£m)	1.06	1.26	1.25	1.54	1.35	1.34	1.33	1.31	10.43

For the reasons stated above, we request that Ofgem revise their analysis of the proposals made under this reopener to take these issues into account. We welcome any further engagement required following this consultation to support further analysis ahead of the final decision on this reopener.

Yours sincerely



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<sup>6</sup> [https://www.ofgem.gov.uk/sites/default/files/docs/2015/09/150929 - determination- riio\\_gd1\\_review\\_street works\\_costs\\_0.pdf](https://www.ofgem.gov.uk/sites/default/files/docs/2015/09/150929_-_determination-riio_gd1_review_street_works_costs_0.pdf)

## Appendix 1 – Details of calculation of forecast volumes

Reopener schemes	Type	DNO	Date established
East of England	Permit	EPN	05/11/2012
Buckinghamshire County Council	Permit	EPN	04/11/2013
Norfolk	Permit	EPN	06/05/2014
Essex	Permit	EPN	16/03/2015
Central Bedfordshire	Permit	EPN	01/04/2016
Cambridgeshire	Permit	EPN	03/10/2016
Thurrock	Permit	EPN	09/10/2017

Table 1. List of schemes and implementation dates

Scheme	2015/16	2016/17	2017/18	2018/19	Average per scheme
Bedford UA	121	345	296	300	265
Buckinghamshire County Council	156	128	131	132	137
Cambridgeshire County Council	0	505	869	1053	961
Central Bedfordshire	147	390	333	411	378
Essex County Council	2922	3094	2636	3040	2923
Hertfordshire County Council	2166	2412	2226	2693	2374
Luton Borough Council	237	262	257	241	249
Norfolk County Council	1319	1333	1175	1516	1336
Southend-on-Sea Borough Council	382	504	396	419	425
Thurrock Council	0	0	104	308	308
Total	7451	8972	8423	10113	9357

Table 2. Calculation of average excluding years in which schemes were not operational, orange cells denote years in which schemes were not in operation for the entire year. Note that Bedford UA, Luton Borough Council, Hertfordshire County Council and Southend-on-Sea Borough Council make up the East of England scheme as presented in Table 1 above. Please also note that totals are accurate but may not reflect sum of individual scheme values as presented due to rounding (connections related permit volumes inside price control are allocated through apportionment resulting in values that are not whole numbers).

## Appendix 2 – Details of calculation of efficiency

	2015	2016	2017	2018	2019	2020	2021	2022	2023	ED1 total efficiency	Equivalent annual average efficiency	Weightings for type of work
Load related capex	1.00	0.99	0.99	0.98	0.97	0.97	0.96	0.95	0.95	-5%	0.63%	6%
Non-load related capex	0.99	0.98	0.97	0.97	0.96	0.95	0.95	0.94	0.93	-6%	0.76%	26%
Faults	0.98	0.97	0.96	0.95	0.94	0.93	0.92	0.91	0.90	-8%	1.02%	68%
											<b>Weighted average efficiency</b>	<b>0.93%</b>

Table 3. Calculation of annual equivalent efficiency from ED1 Final Determinations. Source: EPN RIIO-ED1 BPDT 2014.