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Dear Paul,

Thank you for the opportunity to respond to the "Consultation on the ex-post efficiency review of National Grid Gas Transmission's Milford Haven pipeline project".

In summary Ofgem's Minded to Position is to:

- Maintain current regulatory treatment of logged up costs and TPCR overspend as costs have not been identified which are demonstrably inefficient or unnecessary.
 - o This position also does not increase our allowances to take account of exceptional costs, as in hindsight Ofgem and their consultants have identified project costs of up to £200m that could have been avoided through a different contracting strategy and route selection
- Adjust 15/16 revenues to account for additional £14.5m of project costs that were not attributed to the Milford Haven project

Our response is structured to cover each of the elements contained in the Minded to Position.

"Costs have not been identified which are demonstrably inefficient or unnecessary"

We are very proud that we successfully delivered the Milford Haven project, managing stakeholder expectations and enabling commercial gas flows. In 2007, the company built 200kms of pipeline within one build season, with the required Secretary of State consent only being granted in February. This was achieved despite significant protestor activity, over very difficult terrain and during the wettest weather period on record between May and July. Through Ofgem's efficiency review we have shown that considering the extremely challenging programme and the exceptional circumstances encountered, the Milford Haven project was delivered efficiently within the constraints imposed. Given the above we agree with Ofgem's conclusion that the costs were not demonstrably inefficient or unnecessary.

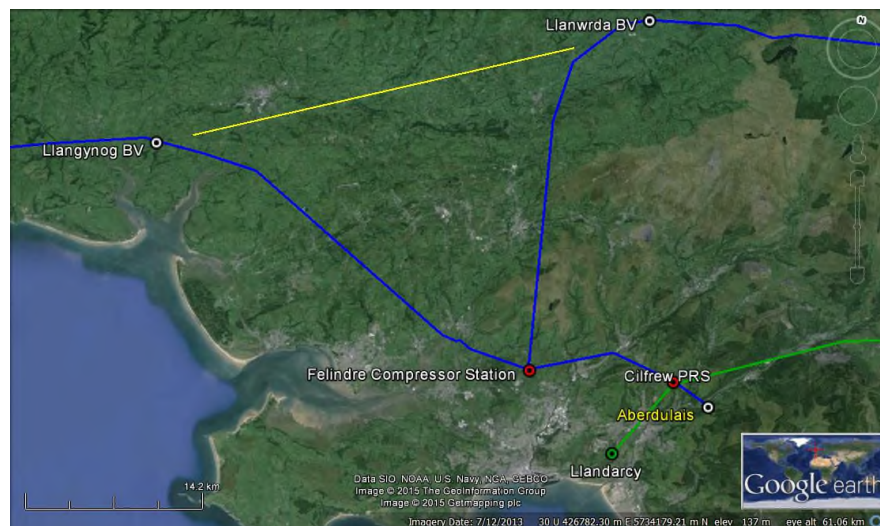
“£200m of project costs could have been avoided in hindsight”

We disagree with the finding that £200m of project costs could have been avoided in hindsight. Below we summarise our key points on Ofgem’s minded to position, which relate to route selection and contracting strategy.

Route Selection

Rune/Penspen summarise:

NGT could have rationalised the pipeline routing in the Carmarthen/Swansea/Brecon area with possible savings in the order of up to £100m as described in Section 4.2.2.



The £100m possible saving is based on cutting the corner as shown in the map produced by Rune/Penspen and reducing the diameter of the spur line between Llangynog and Cilfrew. Rune/Penspen did not undertake any routeing study, but on “simple consideration” deem that it would have been possible to construct the pipeline direct from Llangynog to Llandwra, a distance of 40 km as the crow flies. We disagree with this conclusion for the following reasons:

All routeing options were considered at the time in detail rather than the “simple consideration” analysis used to justify £100m possible savings

National Grid considered a full range of options at the time, including subsea routes, all relevant stakeholders including Ofgem were engaged in the process and the decisions were reviewed before the TPCR4 allowances were set. Route selection took into account technical, economical and environmental considerations and the ability to meet the timescales for bringing LNG to the UK. Given the complexity of the project the route selection was subject to intense analysis. The pipeline was originally intended to connect into the existing network at Aberdulais, the network was then to be reinforced from Aberdulais to Tirley following a largely southern route. During the early part of 2005, it became clear that it would not be possible to build and commission the Southern route by October 2007. Other routes were therefore explored and the decision made to follow a northern route from the Felindre compressor station to Llanwrda and from there on to Tirley. The only reason for choosing this longer route was due to the potential ability to complete the build by October 2007.

The decision to follow the northern route was taken in July 2005, this decision was discussed in length with the Ofgem and all relevant stakeholders and it was accepted that this provided the best option to have the potential to deliver the pipeline by October 2007. Notwithstanding the above points we have nevertheless considered whether we could have “cut the corner”, as now suggested by the Rune/Penspen report.

Assessment of the “cut the corner” route

As recognised by Rune/Penspen, we needed to build a compressor station between Llanwrda and Three Cocks AGI. Rune/Penspen state “The initial part of this route lies within the Brecon Beacons National Park where it is assumed it would be virtually impossible to obtain planning permission and elsewhere the route passes through rural areas where the gaining of planning consent may be very difficult and would carry a high risk of rejection, appeals or legal action.” Given these statements it is not clear to us whether the consultants believe the solution would have met the need to deliver the pipeline by October 2007. From our experience, the siting of the compressor station would be akin to the challenges we experienced with gaining planning permission for Tirley, which was subject to a four year delay and therefore without knowing the final location of the compressor station there would have been no possibility to build the pipeline by October 2007.

In summary we fully stand by the routeing decision made by National Grid at the time, which represented the most economical solution to deliver the project in the timescales required. Given the level of rigour undertaken contemporaneously on the options we believe it is inappropriate to suggest potential savings of up to £100m based on, in the consultants words, “simple considerations”. We also believe it is inappropriate for a TPCR4 efficiency review to revisit decisions, such as the routeing decision, agreed at the time by Ofgem. This is especially the case in relation to Milford Haven where the decision pre dates the TPCR4 price review and allowance setting.

Contracting strategy

Rune/Penspen summarise:

Possible overspend as a result of the lost opportunity to award the northern pipeline route to three separate contractors and avoid acceleration of the initial 122km pipeline construction is described in more detail in Sections 3.5 and 3.6. By simple comparison of MWC outturn cost/km, overspend of more than £100m could be attributed to this lost opportunity.

We disagree with the approach of assuming the same unit cost for the Felindre to Brecon section as for the Brecon to Tirley section would be achievable if more contractors were deployed with a different form of contract for the following reasons:

Based on Penspen’s own analysis, commissioned by Ofgem in 2005, using a robust engineering model shows the unit cost for Felindre to Brecon based on the pipeline’s characteristics is about 25% higher than for Brecon to Tirley.

Penspen wrote a report for Ofgem in 2005 to evaluate the costs of building the Felindre to Tirley pipeline, which was a detailed assessment taking into account factors such as terrain, crossing types and bends. As part of the information we provided to Ofgem, we updated this analysis, without changing any of the cost information, this showed that for the as built conditions the anticipated costs would be as shown in the table below:

Pipeline Section	Estimated unit cost (£m/km)
Felindre to Brecon	£2.8m/km
Brecon to Tirley	£2.2m/km

In Penspen's own words they stated in 2005 *"the site visit concluded that site conditions for pipeline construction were difficult on the western side of the route and in general were easier the further east you travelled along the pipeline route"*.

The exceptional issues of consent conditions, weather and protestors disproportionately affected the Felindre to Brecon section

In addition to the pipeline characteristics, the differing impact of the exceptional events needs to be taken into account. The exceptional events, described below, had a disproportionate impact on the Felindre to Brecon pipeline. Specific examples of this are as follows:

- **Planning & Consents**

Of the 53 planning and consent conditions, there were specific arduous requirements relating to the section of the pipeline (Felindre to Brecon) that lay in the National Park. These are reproduced in Appendix 1:

These planning consent conditions were unprecedented for a gas pipeline and added significant disruption and uncertainty to the work programme. As they specifically related to works within the National Park the cost increase was much more acute on the Felindre to Brecon section.

- **Weather**

The impact of weather on the programme of work is location specific and the relevant weather station for the Felindre to Brecon section (which is the section that had the greatest weather impact) is Sennybridge in Powys. The weather station data is presented below and shows the rainfall was significantly worse than the 1 in 10 year rainfall range both in terms of total rainfall and number of days of rain between May and July. This is statistically the worst weather for this period since records began.

Sennybridge Weather Station – Data

Month	Monthly rainfall totals (1 in 10)	Monthly rainfall totals (2007)	Days of rain (1 in 10)	Days of rain (2007)
May	85	147	5	11
June	93	120	6	4
July	82	251	5	15

In considering the impact of weather it is also necessary to consider the terrain, as described above the topography of the Felindre to Brecon pipeline was much more challenging than for Brecon to Tirley. Compounding the topography with the weather experienced and also the protective measures required, due to working in the National Park, the work and cost impact of the weather was significantly higher for the Felindre to Brecon section.

- *Protestors*

Although protestor action occurred along the length of the pipeline, requiring increased security, the main areas of co-ordinated and disruptive opposition were at Penpont (Felindre to Brecon) Forest Gogh, Trebanos and Cilfrew (Milford Haven to Aberdulais).

With regard to Penpont, protestors occupied an area of woodland at the Penpont Estate blocking construction activities. All work was suspended while negotiations were entered into with the protestors and land owners seeking their removal. In parallel, discussions took place with South Wales Police seeking action by them to remove the protestors. Negotiations with the protestors/land owner were unsuccessful and the police indicated it was for National Grid to take civil action. It took 4 months to gain the eviction of the protestors from the Penpont Estate blocking construction activities for a total of 6 months. Injunctive relief was sought by National Grid and granted at Cardiff High Court. National Grid then engaged High Court Enforcement Officers (HCEO) totalling around 100 to plan and carry out an operation to remove the protestors. The HCEO employed a team of specialist tunnellers and climbers who worked with National Grid's security guards from Kestrel. The team entered the protestor camp on the 27th June 2007, the eviction took 6 days. Specialist security contractors were then used to secure the site post operation.

The combination of the exceptional events and the inherent pipeline characteristics resulted in the difference in cost between the Felindre to Brecon and the Brecon to Tirley pipelines.

Finally, there is no substantiated evidence that using different contractors or a different form of contract would have reduced the outturn cost. The options regarding the contracting strategy were thoroughly considered and discussed with Ofgem and their consultants at the time. The consultant's concluded "*....National Grid has very little room to manoeuvre on these projects and that National Grid is carrying out these projects as efficiently as it is possible to do so.*" In addition in Penspen's 2005 report they estimate the additional cost of increasing the number of contractors as approximately 5-10% per contractor of the baseline cost, thus increasing the number of contractors could well have increased the actual outturn cost.

For the reasons outlined above, we disagree with the conclusion that there was circa £100m of potential savings from an alternative contracting strategy.

"Adjust 15/16 revenues by £4m to account for additional £14.5m of project costs that were not attributed to the Milford Haven project"

In calculating the proposed revenue adjustment, Ofgem has moved £14.5m of costs, associated with CNI infrastructure and an incident at Wormington, onto the Milford Haven scheme and then assumed that this should all be subject to the 25% capex incentive. Based on the time value of money Ofgem state that this equates to a £4m adjustment in 2015/16 revenues. We disagree with the £4m revenue adjustment for the following reasons:

Incident at Wormington

The treatment proposed by Ofgem would subject the Wormington incident costs to the capex incentive twice. The costs of the Wormington incident were originally allocated to non-load capital expenditure and therefore the TPCR4 capex incentive has already been applied to these costs. Moving the costs now into the Milford Haven scheme and applying the capex incentive again is

applying the capex incentive twice. Reallocating the Wormington incident costs to the Milford Haven scheme and removing them from relevant non-load expenditure should have zero impact and therefore it is inappropriate to adjust revenues for the Wormington incident.

CNI infrastructure costs

In terms of the CNI element, there are two aspects to consider. Firstly if the cost of £5.38m (£4.8m in 09/10 prices) is included as part of the Milford Haven scheme, with no allowance adjustment, it would effectively be treated as an overspend. If these costs are also removed from the logged up ISS costs, they will not have been included as part of our revenue or RAV. Irrespective of any proposed revenue adjustment the legacy RAV needs to be increased by £4.8m (in 09/10 prices) to reflect the costs incurred on CNI.

The second aspect is that the CNI requirement was not known when the Milford Haven allowance was set in November 2006. National Grid therefore logged up these costs (£5.38m) as part of the ISS mechanism and the costs were deemed value for money by the independent VFM2 audits. If the costs are to be attributed to the Milford Haven scheme then there needs to be a corresponding adjustment to allowances.

The correct treatment would be to take the costs associated with ISS (£5.38m) minus the non ISS security costs (£152,228) which formed part of the original Milford Haven Allowance. The net amount of £5.23m needs to be included into the Milford Haven Allowance and the capex incentive only applied to the £152,228.

For the reasons outlined above we disagree with the proposed revenue adjustment of £4m and we would like to ensure through discussions with Ofgem that any reallocation of costs incurred in relation to CNI does not inadvertently remove these costs from the Regulatory Asset Base.

Conclusion

Through Ofgem's efficiency review we have shown that considering the extremely challenging programme and the exceptional circumstances encountered, the Milford Haven project was delivered efficiently within the constraints imposed.

We believe through this response we have shown that the analysis that underpins the potential savings of £200m identified by Ofgem's consultants is not justified.

Given we disagree with the findings of the review and believe we have provided clear evidence that large elements of the overspend were due to exceptional events, we disagree with Ofgem's conclusion that it would not be appropriate to increase NGGT's allowed revenues to reflect these exceptional events.

Finally, if Ofgem chooses to reclassify spend from non-load expenditure and CNI categories to the Milford Haven project, it should recognise the movement of associated allowances and any capex incentive that has already been applied. We believe this would remove the proposed revenue adjustment of £4m.

If you would like to discuss any aspect of our response, please do not hesitate to contact me.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'Chris Bennett', with a long horizontal flourish extending to the right.

Chris Bennett
Head of RIIO Delivery

Appendix 1 – Relevant Consent Conditions

Brecon Beacons National Park

46. All construction, re-instatement and restoration works in the Brecon Beacons National Park shall be in accordance with the measures agreed under Conditions 9, 10 and 11.

47. All construction, re-instatement and restoration works in the Brecon Beacons National Park shall be overseen by a person nominated by the Brecon Beacons National Park Authority (BBNPA), for whom National Grid shall allow input, advice and influence on actions (and additional actions should method statements prove either not to be effective or ineffectively executed) in compliance with Conditions 9, 10 and 11 at affected locations within the Brecon Beacons National Park.

48. Any person nominated pursuant to Condition 47 shall be given direct access to the relevant Project Manager(s) at National Grid to report any construction activity which in his/her view would cause irreversible damage or is outside the terms of agreed method working statements or otherwise agreed under Conditions 9, 10 and 11. National Grid shall cause a halt to such works until such time that the situation has been investigated and it is possible for works to resume in accordance with the agreed method statements or any variation which may be agreed in writing by the BBNPA.

49. A management restoration plan shall be approved in writing by the BBNPA which shall include a programme for the monitoring and aftercare of the restored areas of the Brecon Beacons National Park.

50. Pursuant to Condition 49 should monitoring or aftercare indicate that corrective action is required to improve the effectiveness of any agreed restoration and/or mitigation then proposals of measures to be undertaken shall be submitted to the BBNPA for approval in writing. Any corrective action shall be implemented by National Grid at a time to be agreed with the BBNPA. Any aftercare shall be for a period of 10 years from its start or any such longer or shorter period as may be agreed in writing by the BBNPA.

9. The installation of the pipe-line or advance soil stripping, ancient woodland plant translocation and turfing operations at the locations identified in the list attached ("affected locations"), shall not take place until National Grid has agreed, in writing, with the CCW, NE and the relevant Local Authority, restoration plans for these locations which shall include operational and site specific method statements, and a programme for their restoration, works and monitoring during construction, re-instatement and restoration. The measures agreed in the plans shall be carried out in accordance with the programme included in the plans, unless otherwise agreed in writing with the CCW, NE and the relevant Local Authority. In the event that adequate habitat restoration is not deemed possible a compensation package within the locality shall be included in the monitoring and aftercare plans required by Condition 10.

10. Prior to the completion of construction works for the pipeline, monitoring and aftercare plans for the affected locations shall be submitted to the CCW, NE and the relevant Local Authority for approval. These plans shall include on-site and off-site enhancement opportunities as appropriate for the affected locations. The measures agreed in the plans shall be carried out in accordance with the programme included in the plans and any aftercare shall be for a period of 10 years from its start date or any such longer or shorter period as may be agreed in writing by the CCW, EA or relevant Local Authority.

11. The results of the monitoring required pursuant to Condition 10 shall be supplied to the CCW, NE and relevant Local Authority which may, if considered necessary, indicate corrective action to improve the effectiveness of any agreed mitigation. National Grid shall convene meetings as appropriate with the CCW and/or NE to review affected sites, habitats and species monitoring issues. Any corrective action indicated by the CCW, NE or relevant Local Authority shall be implemented by National Grid at a time to be agreed in writing with the CCW, NE or the relevant Local Authority.