

Interested parties and
stakeholders

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Dear colleagues,

RIIO-T1: Our decision on National Grid Gas Transmission's application under the Quarry and Loss Development Claims Costs reopener

This letter sets out our¹ final decision on National Grid Gas Transmission's (NGGT) price control reopener application, made under Special Condition 5E (Arrangements for the recovery of uncertain costs) of NGGT's Gas Transporter licence, for an additional allowance of £23.1m² to cover Quarry and Loss Development Claims (Q&L) costs.

On 8 August 2018, we published a consultation on our assessment of NGGT'S application and sought the views of interested parties.³ We received one response (from NGGT), of which a non-confidential version has been published alongside our consultation.

Our final decision

Having considered the response from NGGT and taking account of our principal objective and statutory duties, and in accordance with Special Condition 5E of NGGT's Gas Transporter licence, we have decided to increase allowances by £19.2m, which is slightly lower than our initial view (by £34k). We have decided to allow NGGT's requested allowances in all areas except the following:

- We have decided not to allow £1.7m for a claim for loss of mineral development costs at "Quarry C". NGGT are currently not liable for these costs due to a court ruling affecting the claimant's right to the claim and we do not expect this to change in RIIO-T1.
- We have decided not to allow £2.2m for drainage works in the South West. This is because we think that NGGT's requested allowances for the South West are significantly higher (per job) than elsewhere in Great Britain (GB) and the outputs could have been more efficiently delivered through improved contractor management. We have made a slight reduction of £34k to our consultation position

¹ The terms the 'Authority', 'Ofgem', 'we' and 'us' are used interchangeably in this letter. The Authority is the Gas and Electricity Markets Authority. Ofgem is the office of the Authority.

² All costs in this document are reported in the 2009/2010 price base, unless otherwise stated. All costs presented have been rounded which may appear as rounding errors. The final allowance profile should be taken from the allowance profile in the next steps section.

³

https://www.ofgem.gov.uk/system/files/docs/2018/08/quarry_and_loss_nggt_consultation_document_ofgem_public_version_-_may_2018.pdf

following clarification by NGGT in its consultation response about the number of drainage jobs in the South West.

The requested and allowed adjustments are shown in Table 1.

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

	Requested adjustment for RIIO-T1 (09/10 prices)	Allowed adjustment for RIIO-T1 (09/10 prices)	Difference
Loss of crop	£7.8m	£7.8m	£0.0m
Drainage	£8.3m	£6.1m	£2.2m
Loss of land development	£2.7m	£2.7m	£0.0m
Sterilised minerals	£2.5m	£2.5m	£0.0m
Quarry C	£1.7m	£0.0m	£1.7m
Total	£23.1m	£19.2m	£3.8m

The remainder of this document sets out the background to NGGT's application and the reasons for our decision.

Background

Q&L costs arise from claims made by landowners to compensate for losses due to the presence of a gas transmission pipeline affecting the productivity or limiting utilisation of the land. These cover a range of land uses, including farming, quarrying and property developments. NGGT remunerates claimants for their financial losses once the case for compensation has been proven.

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

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

Our assessment of NGGT's application was in two phases. Phase one was an informal consultation on its submission, from 17 May to 20 June 2018.⁴ We received one response from Centrica, which we addressed in our consultation. Phase two was a formal consultation from 8-29 August 2018, in which we set out our initial view of our assessment of the application.

Reasons for our decision

Loss of Crop

In our consultation, our initial view was to allow the amount requested by NGGT of £7.8m, which was divided into two areas: annual claims (£4.3m) and full and final (F&F) settlements (£3.5m). We considered that NGGT's process for settling annual claims appears reasonable and we think that it has appropriately challenged the claims it has received for loss of crop. We also welcomed NGGT's policy shift towards focusing on F&F settlements rather than annual payments, as we agree that it is a more cost-efficient way of handling loss of crop claims in the longer term and provides better value for energy consumers.

⁴ [Informal consultation on RIIO-1 price control reopeners \(May 2018\)](#)

We received no feedback on this cost category. Our view therefore remains unchanged from our initial view. We are satisfied with NGGT's forecasts and have decided to allow the full amount of requested allowances to cover loss of crop costs (£7.8m).

Drainage remedial works

In its May 2018 submission, NGGT sought £8.3m (subsequently adjusted by NGGT to £8.1m) to cover the cost of historical and forecast drainage works during the RIIO-T1 period. The submission included that the unit cost for works in the South West region is higher because of contractor resource constraints in the past. As a result of these constraints, NGGT experienced delays in carrying out drainage remedial works in the South West region for a number of years. These delays meant that the work required for each job has increased in scope, scale and complexity – leading to higher unit costs than seen in the rest of GB.

In our consultation, our initial view was that NGGT's requested allowances for drainage works in the South West were too high. Our comparison of the requested allowances on a "per job" basis showed that jobs in the South West were significantly more expensive than jobs elsewhere in GB. We said that we did not believe that NGGT had acted in the most efficient way when it came to drainage remedial works in the South West region. We considered that these delays and consequent cost increases should have been identified and managed better by NGGT. NGGT appointed its contractors for the South West region in 2011, and then in 2016 extended the contract by six months. The problems with contractor resources should have been apparent to NGGT early on in the current price control period in 2013/14 and 2014/15. In these first two years of the price control, no jobs were completed in the South West (compared with 251 completed jobs in the rest of GB). It was only by 2017 that NGGT had set up a new framework contract to tackle these issues.

As a result, our initial view was to reduce NGGT's requested allowances for drainage works by £2.1m. This was based on NGGT's own forecast unit costs for the other regions. Part of our rationale for proposing this reduction was due to our view that NGGT had acted inefficiently with regards to its handling of the contractor in this area.

In its response to our consultation, NGGT accepted our initial view regarding its inefficient handling of its contractor, providing that "*[we] accept that we could have more expediently addressed the contracting issues in the South West, and thus Ofgem's assessment with regards to this element is reasonable.*"

With regards to unit costs, NGGT disagreed with our proposed adjustment to drainage allowances for the South West region. The response argued that drainage jobs in the South West region are significantly more expensive than the rest of GB for reasons outside of NGGT's control. NGGT explained that "*[the] higher costs in the South West region are predominantly as a result of the more challenging terrain (permanent pasture, undulating land, high altitude with significant annual rainfall), particularly in South Wales, which means the drainage works required are more complex and take longer for the contractors to resolve. It is difficult to assign a specific additional cost in relation to the delay in responding to these claims; however, this is not considered to be the main driver behind the cost increase in this region.*" NGGT provided further information about the efficient unit costs for the South West region, taking account of these factors.

NGGT commissioned its contractor to carry out a review of reasonable costs for drainage jobs in the South West. The review considered four drainage jobs in the South West dating back to 2013 and 2014. The review sought to estimate the proportion of the difference between unit costs in the South West region and those in the rest of GB that was attributable to factors outside of NGGT's control (such as the complexity of the works), and the proportion that was caused by the delays in carrying out the work. The review concluded that approximately 40%-50% of the difference in unit costs was due to delays, with the rest being due to the complexity of the works. NGGT therefore proposed that we

use a unit cost that includes 55% of the difference. This would result in an increase in allowances of £0.8m compared with our initial view.

We welcome the fact that NGGT has accepted that it could have acted more expediently to resolve the contracting issues in the South West, and that it has taken action to resolve the issue now. However, we are not convinced by NGGT's analysis of the causes of the higher unit costs in the South West. In particular, we note that the four jobs that were selected for NGGT's review (carried out in 2018) are in the same area (along Feeder 28) and date back to 2013 and 2014. We have no evidence to suggest that these jobs are representative of the typical drainage job in the South West region. The sample of jobs reviewed is small and, considering that NGGT is carrying out 98 drainage jobs in the South West region alone in the RIIO-T1 period, it would not be reasonable or appropriate to determine allowances for all 98 jobs based on a review of four jobs. We also note that at the time the review was undertaken, there had already been delays of 3-4 years. We would have expected NGGT to provide evidence from jobs that were not affected by delays; we think those would have provided better comparators. Moreover, the attribution of 40%-50% of the additional cost to delays is based on a subjective view and NGGT has not provided any explanation for how it has been determined, with the result that we are unable to verify that this assumption is reasonable.

We therefore believe that NGGT's response does not provide a sufficient basis for moving away from our initial view, which was based on GB-wide unit costs. NGGT has not demonstrated that drainage jobs in the South West are inherently more difficult, complex or more expensive to address than jobs elsewhere in GB.

We note the point made in NGGT's response that the forecast number of drainage jobs in the South West should be 98 rather than 106, which we had used to calculate allowances set out in our consultation document. We have accordingly reduced our allowance by £34k.

In conclusion, our decision on drainage remedial works is to allow a total of £6.1m, which is a reduction of £2.2m compared to NGGT's requested allowances.

Loss of Development

NGGT sought £2.7m in respect of loss of development costs, which relate to eight claims for compensation as a result of being unable to use land near pipelines. In our consultation, our initial view was to allow the amount requested by NGGT.

We received no feedback on this cost category. Our view therefore remains unchanged from our initial view. We are satisfied with NGGT's actual incurred expenditure and forecasts and have decided to allow the full amount of requested allowances to cover loss of development costs of £2.7m.

Sterilised Minerals - general claims

NGGT requested £2.5m to cover four settled claims and two future claims in respect of sterilised minerals (excluding 'Quarry C', which was considered separately). Both of the future claims are forecast to be completed within the RIIO-T1 price control period and we accept NGGT's liability for these costs. Our initial view was to accept NGGT's request for £2.5m in respect of all four claims.

We received no feedback on this cost category. Our final decision therefore remains unchanged from our initial view, and we will allow the full amount of requested allowances (£2.5m).

Sterilised Minerals - 'Quarry C'

NGGT requested an allowance of £1.7m to cover the costs of a potential claim relating to 'future works to decommission a stretch of pipeline which passes through a quarry ('Quarry

C)'. In our consultation, our initial view was that due to the considerable uncertainty around whether NGGT would be liable for any of these costs, we proposed to not provide any allowance.

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

Centrica Group specifically addressed this area of the reopener in their response to the informal consultation. It also considered that the uncertainty of NGGT's liability for any costs was substantial and that "NGGT should not be provided with funding for the decommissioning of the pipeline until it is certain the costs will be incurred".

NGGT's response to our consultation accepted our initial position on the allowances for Quarry C, however, it asked Ofgem to acknowledge that "if the activities at Quarry C are undertaken, National Grid will be held whole as part of the RIIO-T1 close out process".

We do not think it appropriate or proportionate for us to provide a guarantee of future funding for any works undertaken at Quarry C during the RIIO-T1 period. NGGT can apply for appropriate funding as part of future price control reviews if it believes that any works will be necessary.

Our final decision therefore remains unchanged from our initial view, as we consider there is insufficient certainty around the final outcome and timing of this claim to justify providing NGGT with an allowance.

Next steps

Our final decision on NGGT's allowances for Q&L costs is set out below.

Table 2: Requested and final allowance profile for NGGT's Q&L costs.

£m (09/10 price base)	13/14	14/15	15/16	16/17	17/18	18/19	19/20	20/21	Total RIIO-T1
Requested Allowed Expenditure	3.486	1.999	2.098	2.882	3.702	3.476	4.064	1.349	23.057
Final Allowed Expenditure	3.486	1.999	2.098	2.882	3.702	2.563	1.496	0.948	19.175

Our decision will be implemented through the 2018 Annual Iteration Process, which means that these adjustments to NGGT's allowed revenues will take effect from 2019/20.

Please contact Kiran Turner (kiran.turner@ofgem.gov.uk) if you would like to discuss any aspect of this letter.

Yours faithfully,

Geoffrey Randall
Deputy Director, Gas Network Price Controls