Electricity Distribution
National Grid
Avonbank
Feeder Rd
Bristol
BS2 0TB

nationalgrid

Anthony Mungall
Ofgem
Commonwealth House
32 Albion Street
Glasgow
G1 1LH

2 August 2024

Dear Anthony,

NGED Response to the RIIO-ED1 Closeout: Consultation on proposed adjustments.

I am writing on behalf of National Grid Electricity Distribution (NGED), in relation to Ofgem's RIIO-ED1 ('ED1') Closeout consultation on proposed adjustments, published on the 7th June 2024. NGED welcomes the opportunity to respond to this consultation, and we have also appreciated the engagement with yourselves ahead of this, through bilateral meetings and supplementary questions (SQs).

We are in agreement with Ofgem's proposed position to make no further adjustments to NGED's RIIO-ED1 allowances, other than for Specified Street Works Costs (SSWC). We request Ofgem consult with us ahead of the final decision should any adjustments occur to NGED's RIIO-ED1 allowances as part of this ED1 Closeout consultation process (other than the matters raised below).

In this letter, we set out our response to Ofgem's proposed adjustment for SSWC. We welcome that Ofgem has followed a broadly similar approach to what we proposed in our SSWC closeout submission (which we based on Ofgem's decision in March 2021 on the RIIO-ED1 closeout methodology for SSWC) and are therefore supportive of this assessment.

However, we wish to outline some minor areas of clarification with this assessment approach:

- The inclusion of SWEST to inform the calculation of the benchmark;
- The use of the 3% efficiency adjustment;
- Minor amendments required to the StreetWorksCosts.xlsx Model

We also provide our understanding of the treatment required for applying the calculation of adjustments through the PCFM.

We discuss each of these points in turn below.

The inclusion of SWEST to inform the calculation of the benchmark
Volume and cost data for SWEST should not be included in the calculation of the benchmark for Street works.

For the closeout claim for SSWC in ED1 in September 2023, we did not claim for a proposed adjustment to allowed expenditure for SWEST. In line with Ofgem's prescribed closeout methodology, we only submitted closeout claims for SSWC for EMID and WMID, as we judged that an adjustment for SWEST would fall under the materiality threshold using SWEST's own unit cost.

As we did not submit a claim for SWEST, its cost and volume data should not be included in the benchmark calculation. Following Ofgem's closeout approach, it is illogical to include a licensee that does not have an adjustment to allowed expenditure at the point of the ED1 closeout. In paragraph 7.8 of the ED1 Closeout Consultation, Ofgem state, *"We have then extended the benchmarking exercise to all licensees that have requested additional SSWC funding, either in 2019 or as part of this closeout."* We acknowledge that NGED proposed an adjustment to SWEST in the 2019 re-opener. However, at this point, it was not clear how Ofgem would assess SSWC. Ofgem determined our 2019 re-opener claim for SWEST could not be assessed, as SWEST did not have 12 months of actual cost data at the time of NGED's re-opener submission. If this approach had been known ahead of the 2019 re-opener, then no claim would have been made for SWEST.

On this basis, SWEST should be removed from the closeout calculation.

The use of the 3% efficiency adjustment
The 3% efficiency adjustment is not justified and should be removed.

For the Street works 2019 re-opener decision, Ofgem applied a 3% efficiency adjustment to proposed allowances over the last four years of ED1. This was to reflect the potential deemed future level of cost savings possible through efficiencies and innovation. In our closeout claim for SSWC in ED1, we argued that the efficiency adjustment is not required in the calculation of closeout allowances, and we maintain this conclusion.

In principle, benchmarking DNOs' unit costs applies a natural efficiency challenge, determining how efficient a DNO is in respect to another. Within the ED2 Cost Assessment Modelling Suite, benchmarking is performed on actual and forecast costs, with the efficiency challenge calculated and applied to forecast costs only. At the time of the 2019 SSWC Re-opener, it could be understood why an efficiency challenge was applied, as the costs from 2020-2023 were indeed forecast. However, the SSWC Closeout ED1 model (StreetWorksCosts_FINAL.xlsx) has now been updated with the actual cost data from RRP 2022/23, and so there is no longer a requirement to use forecast data. Any forecasted efficiency adjustments at the time of the 2019 SSWC Re-opener are now embedded within the actual reported unit cost data, and an additional efficiency adjustment is therefore unnecessary.

Using the latest data from Ofgem's ED1 Closeout Street Works Cost model, this demonstrates that unit costs for total costs have decreased by 5.4% between the 2016-19 average and the 2020-23 average. The 5.4% decrease in average unit costs demonstrates a clear level of efficiency has been achieved, which has been captured in the DNOs' RIGs reporting.

Table 1: Unit costs demonstrate a reduction from 2016-19 average to 2020-23 average (£/unit, 2012-13 prices)

Unit Cost Type	Units	ED1 Average	2016-19 average	2020-23 average	% Difference (2016-19 avg. v 2020-23 avg.)
Total	*£/unit*	202.64	208.31	196.97	-5.4%

Source: Calculations using StreetWorksCosts_FINAL.xlsx model. Tab 'Unit Costs'

In our closeout claim for ED1 SSWC in September 2023, Chapter 4 included evidence on how we are working efficiently and innovatively within the area of Street Works. This includes efficient

practises embedded in ED1 such as the use of Street Manager, ongoing investment in fault-finding equipment and the review of working practises for Dig & Lay contractors. We are committed to achieve further efficiencies throughout ED2, as a result of NGED's ongoing efficiency delivery programmes.

In the 2019 re-opener decision there was no statistical evidence provided by Ofgem to justify the 3% efficiency adjustment, only reference to regulatory precedent from Gas Distribution determinations. Tracing back through the regulatory evidence, Ofgem includes their reasoning for the 3% value in footnote 13 of the 2015 'Consultation for SSWC under the RIIO-GD1 price control review', as an average derived from Ofgem's assumptions for efficiencies and impact of innovation in RIIO-GD1[1]. These assumptions would have been different for ED1 but no updated calculation was made for use in ED. The 3% efficiency adjustment is also significantly higher than the overall efficiency adjustment which Ofgem most recently applied in RIIO-ED2, which set an ongoing efficiency challenge of 1%.

Furthermore, as per the RIIO-ED2 Final Determinations Core Methodology document[2], Ofgem recognised that Street Works costs influence DNOs differently, due to how local authorities operate and due to the different rates in how permit and lane rental schemes have been rolled out, limiting the suitability of Street Works costs for comparative benchmarking. This provides further evidence on the lack of applicability for a consistent efficiency adjustment for all DNOs.

Reflecting on these points, no further efficiency adjustment is required, and the 3% efficiency adjustment should be removed from the calculation of proposed adjustments to allowed expenditure for SSWC post 2019.

The StreetWorksCosts.xlsx Model
We propose 2 minor amendments to the Street Works model.

NGED has appreciated the opportunity to review the "StreetWorksCosts_FINAL.xlsx" model. We have reviewed the data and methodology in detail, and have no further comments. For completeness, we find two small issues that have no impact on the calculation of the efficient unit cost, but warrant highlighting for amendment in the final model:

- Tab 'Unit Costs', cell C11, this cell should read 'Volumes' but currently says 'Costs'.
- Tab 'Allowance' cell range Q51:X55, it is not clear what this data is being used for. As the formula within this range says that for years 2020+, the modelled spend after efficiency is being multiplied by the efficiency challenge again. We suggest that this range is removed.

Operational treatment of applying the calculation of adjustments through the PCFM
The treatment specified in chapter 8 of the RIIO-ED2 Price Control Financial Handbook (PCFH) is appropriate and correct.

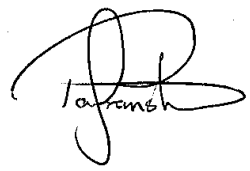
In relation to the operational treatment of applying the calculation of adjustments through the

[1] For efficiencies, Ofgem assumed an annual 0.8% reduction in line with the RIIO-GD1 final proposals; for innovation, Ofgem assumed 0.7% starting in 2015 and increasing by 0.5% each year, from 2015-2021. Taking the average of the efficiency (0.8%) + average value for innovation (2.2%) sums together to achieve the 3% value.
[2] Paragraph 7.529.

PCFM, we believe the treatment specified in chapter 8 of the RIIO-ED2 Price Control Financial Handbook (PCFH) is appropriate and correct. As set out in the PCFH, Legacy inputs directed by the Authority are adjustments relating to ED1 Variable Value methodologies and ED1 Closeout methodologies, which are then implemented in the ED1 Legacy PCFM. The PCFH also sets out the update process for the ED1 PCFM and offline ED1 tax trigger PCFM to reflect any adjustments and derive inputs to the ED2 PCFM. The Street Works Closeout adjustment values are Legacy inputs directed by the Authority. No further amendments to this approach are required.

We welcome the opportunity to work with you through the RIIO-ED1 Closeout consultation process to resolve these outstanding queries. Please contact Dawn Broderick at dbroderick@nationalgrid.co.uk should you wish to discuss any of this response.

Yours sincerely,



Paul Branston
Director of Regulation
National Grid Electricity Distribution