



# Northern Powergrid response to RIIO-ED1 Closeout consultation on proposed adjustments

## KEY POINTS

- Ofgem has erred when undertaking the tests set out in the licence when assessing High Value Projects. Ofgem does not have the discretion to depart from the licence in this way, and this mistake underfunds Northern Powergrid (Yorkshire) plc (“NPgY”) by £3.44m.
- There is insufficient transparency of the rationale underpinning the Load Related Expenditure reopener minded-to position to understand whether it represents a fair outcome for customers and Distribution Network Operators (“DNOs”) alike.
- Ofgem must improve the methodology used to assess the Streetworks submissions to make better use of the RRP data that is now available and to ensure that DNOs receive appropriate levels of funding. Northern Powergrid (Northeast) plc’s (“NPgN”) allowances should be increased by £8.53m rather than £6.88m.
- In light of the new data, Ofgem has revised upwards the unit cost rates used to determine efficient Streetwork allowances. Ofgem has to apply this approach to NPgY as well as to the other DNOs. NPgY should receive £10.58m in additional allowances.

## 1. Load Related Reopener (LRR)

- 1) We requested no adjustment under the Load Related Reopener in our submission and Ofgem agreed. As such, we make no material representations regarding the outcome of Ofgem's minded to position in respect of Northern Powergrid's Load Related Expenditure allowances.
- 2) However, there is a general lack of transparency regarding Ofgem's justification for the minded to position which limits our ability to ascertain whether the decision represents a fair outcome for customers and DNOs alike, and it is difficult for stakeholders to make an informed assessment. For example:
  - a. No background information has been given regarding proposed adjustments relating to Green Investment, LV visibility or Flexibility Services, and Ofgem has not set out a clear justification to support its decision to allow these adjustments in full for UKPN and SSE.
  - b. Within Ofgem's commentary on its position to accept, reject or adjust values for innovative solutions, seemingly arbitrary stances are taken with no clear basis set-out for these – for example the application of 2020/21 as year of 'BAU' across a number of items.
- 3) In this instance, and going forwards, we recommend that Ofgem sets out the underpinning details of its rationale for decisions such as these to enable an effective review of the rationale behind its decision making.

## 2. High Value Projects (HVP)

### ***A. NPgY's initial submission and subsequent SQs***

- 4) As part of the ED1 closeout process NPgY submitted that it should receive £3.4m in additional allowed revenue for its High Value Projects Costs associated with a project at Doncaster.
- 5) The project involved installing 132kV cables from an existing transmission/distribution interface substation on its network to a new Northern Powergrid 132/33kV substation along with associated work on lower voltage infrastructure.
- 6) This project started in the DPCR5 period. It continued into the ED1 period to allow for major re-engineering of the project because the forecast cost of the original solution increased to the point that it was no longer the most efficient approach.

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- 7) NPgY's efficient ED1 period costs are above its ED1 allowed revenue. NPgY's efficient overall costs for the scheme (DPCR5 and ED1) are above its total allowed revenue for the two periods.
- 8) NPgY's application meets the two tests in Appendix 1 to CRC 3F, Arrangements for the recovery of uncertain costs ("Appendix 1"). The relevant values for those calculations are:
- a. TUCHVPov: £10.73m (CRC 3F.8, Appendix 1, Table 2)
  - b. TUCHVPF: £24.77m (cells AJ62-AJ69 of table M16 in the 2022-23 costs and volumes pack)
  - c. MA: £5.86m (RC 3F.8, Appendix 1, Table 2)
- 9) The funding values for DPCR5 in 2012/13 prices were:
- a. Allowed revenue: £19.81m
  - b. Expenditure: £9.20m
- 10) Having considered properly the materiality threshold, NPgY would understand if Ofgem then looked at the 'overall' position for the full life of the project in determining underfunding for the purposes of the reopener. Taking into account DPCR5 expenditure (£9.21m) and ED1 expenditure (£24.77m) vs. total allowances over the same period of (£30.54m), NPgY should receive £3.44m of additional allowances.

### **B. Ofgem's minded-to position**

- 11) In its RIIO-ED1 Closeout: Consultation on proposed adjustments Ofgem has proposed to make no adjustment to NPgY's allowances for High Value Project Costs.
- 12) Ofgem's explanation – in full – is that:

*The NPgY HVP "Doncaster" project started in DPCR5 and continued into ED1. This project spanned two price controls and, based on the DPCR5 closeout, we are now applying closeout for this project in its totality in ED1. Whilst this approach is not prescribed in either DPCR5 or ED1 we believe that there is a clear justification for using the "whole life" approach when making this decision. The Closeout Methodologies Decision does emphasise the need for examination of the differences between a DNO's allowance and their expenditure (and it being well justified), the overall approach we believe is reasonable and is in consumers' interests. Combining the DPCR5 and ED1 allowances and expenditure for the HVP "Doncaster" resulted in an overspend of £3.44m and no financial adjustment is required.<sup>1</sup>*

- 13) In the accompanying data file Ofgem provides the following figures to support its position, which sets out the calculations required to perform the tests described in Appendix 1:

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<sup>1</sup> Paragraph 4.22 of the RIIO-ED1 Closeout: Consultation on proposed adjustments

Closeout Assessment	NPg Submission <sup>2</sup>	Ofgem View <sup>3</sup>
	NPgY <sup>2</sup>	NPgY <sup>3</sup>
HVP Allowance (a)	10.73	30.54
HVP Actuals (b)	24.77	33.98
Overspend/(underspend) (c) = (b - a)	14.04	3.44
Closeout reductions:- ED2 Forecast (d)	-	-
HVP Underspend after closeout reductions (e) = (c - d)	14.04	3.44
Materiality Amount (f)	5.86	5.86
20% of Allowance (g)	2.15	6.11
Threshold to Pass 3F Test (h)	8.01	11.97
Pass 3F test?	TRUE	FALSE
<b>Closeout Adjustment (e + g)</b>	<b>3.44</b>	<b>-</b>

<sup>2</sup>NPg view of NPgY applies 3F test for ED1 allowance and actuals and claims closeout adjustment based on the combined DPCR5 and ED1 allowances and actuals.

<sup>3</sup>Ofgem view of NPgY shows combined DPCR5 and ED1 allowances and actuals

### C. Ofgem's error

- 14) Ofgem is right when it notes that the approach it has adopted is not prescribed in either DPCR5 or ED1.
- 15) When undertaking the tests set out in the licence, Ofgem has used NPgY's overall figures for allowed revenue and expenditure, rather than its ED1 period figures. But the licence condition does not allow for this.
- 16) Appendix 1 is explicit that the inputs to the calculation must be NPgY's ED1 figures. Three amounts are required to perform the tests:
- TUCHVPov: This is defined in Appendix 1 as "the total opening level of allowed expenditure that is defined as High Value Project Costs as set out in Table 2 plus any additional allowed expenditure determined under previous reopeners under this Condition". For NPgY the value in Table 2 is £10.73m and it has received no additional allowances. (In Ofgem's data file set out above in paragraph 13), this is named "HVP Allowance (a)").
  - "TUCHVPF". This is defined in Appendix 1 as "the proposed revised level of allowed expenditure that is defined as High Value Project Costs". High Value Project Costs are defined as "costs incurred, or expected to be incurred, by the licensee on any investment project with respect to its Distribution System that is reasonably forecast to cost the licensee £25 million or more (in 2012/13 prices) during the Price Control Period, and for which clear outputs, a needs case and a statement of costs have been provided to the Authority". (In Ofgem's data file set out above in paragraph 13), this is named "HVP Actuals (b)").

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- c. "MA": This is defined in Appendix 1 as "the material amount set out for the licensee at Table 2 of this Appendix". For NPgY the value in Table 2 is £5.86m. (In Ofgem's data file set out above in paragraph 13), this is named "Materiality Amount (f)").
- d. Paragraph A1.4(b) of Appendix 1 adds that "[i]n carrying out any calculations pursuant to these tests, allowed and actual expenditure in respect of High Value Project Costs will be considered ... on a total expenditure basis taking account of expenditures incurred, or expected to be incurred, over the entire Price Control Period".
- 17) When Ofgem describes the tests in the consultation it does so correctly, explaining that it "will evaluate a DNO's efficient level of HVP expenditure for RIIO-ED1, which will then be compared against the DNO's allowances for the same period. If Ofgem determines that the difference between these two values is more than 20% different from allowances, and that the amount beyond this 20% deadband is a 'material' amount, then it will calculate the value of any adjustment that needs to be made."<sup>2</sup>

#### ***D. Correcting the mistake in Ofgem's minded-to position***

- 18) As a first step, Ofgem must apply the materiality tests in Appendix 1 in accordance with the defined terms and specified values set out in the licence condition.<sup>3</sup> Ofgem has no discretion to depart from this.
- 19) When done properly NPgY passes the materiality tests. None of the figures are actually in dispute. It is simply a case of using the correct inputs. The result of the correct application of the tests is shown in the NPg Submission Column in paragraph 13 above.
- 20) As a second step, Ofgem must then determine the adjustment to NPgY's allowed revenue. Ofgem only has two options available to it here:
- a. On a straightforward application of the licence condition in its entirety, Ofgem would have to increase NPgY's allowed revenue by £11.89m, reflecting its underfunding during the ED1 period and the application of the deadband. The materiality test and the adjustment to allowed revenue would be calculated on a consistent basis; or
  - b. If - at this stage - Ofgem takes into account the project's overall allowed revenue and efficient costs, such that customers do not overpay, determining that NPgY should receive only a £3.44m increase, NPgY would not challenge that decision. It would be a reasonable outcome.

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<sup>2</sup> Paragraph 4.6 of the RIIO-ED1 Closeout: Consultation on proposed adjustments

<sup>3</sup> NPgY's application also satisfies the other criteria set out in CRC 3F.8 and which are not disputed.

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But Ofgem cannot then revisit the tests from the first step, apply this new figure, and determine that NPgY should not receive any additional funding as it is under the materiality threshold.

### 3. Specified Street Work Costs (SSWC)

- 21) Northern Powergrid's September 2023 reopener submission included notice to apply for additional funding for both Yorkshire and Northeast. The notice for Yorkshire was subject to our understanding of the May 2019 funding decision, which Ofgem has now clarified in its minded-to position. Ofgem has set out an approach where – appropriately – DNOs will receive additional allowances for the higher unit costs they have faced. Ofgem must apply its methodology consistently across all the DNOs, including to Yorkshire. But Ofgem has failed to consider Yorkshire's application at all. The methodology has been applied to Northeast.
- 22) There are flaws in Ofgem's benchmarking methodology. When these are corrected, Northeast should receive £8.53m of additional allowances and Yorkshire should receive £10.58m.
- 23) Ofgem states that the level and quality of the data reported in the RRP has improved and provides more granular insight into the costs and volumes associated with this cost area. However, as applied, the methodology does not leverage this improved insight.
- 24) Given these points, Ofgem should make appropriate modifications to the methodology. We have attached a straightforward benchmarking model that makes these corrections
- 25) The majority of DNOs have a relatively similar per unit cost for the permit itself, however there is significant discrepancy in overall unit cost for permit condition costs. Permit condition costs is both the area where the DNOs have the greatest divergence in unit cost and where the quality of information is much improved – yet this data is not used.
- 26) If Ofgem looks more closely at the individual conditions and establishes a benchmark average unit cost per condition type, there is a wide range in the costs incurred. For example, the industry average cost of "*NCT11a – Consultation and publicity*" is £29.12 per condition, whereas the average "*NCT08b – Traffic Management*" is £1,029.64 per condition. The application of a flat unit rate per permit for permit conditions significantly and unjustifiably disadvantages DNOs that have been required to implement higher cost conditions, such as wider traffic management, whilst over-rewarding DNOs that happen to have incurred lower cost conditions.

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- 27) Given the improvement in granularity and data quality, Ofgem must undertake a more granular approach in this area to ensure a more equitable assessment of the efficient cost for managing street works.
- 28) The application of a retrospective efficiency target to historical actual data is irrational and inconsistent with the 2019 decision. The 2019 reopener, which covered a request for funding that included both historical actual and forecast expenditure, correctly had no “efficiency challenge” applied to the historical actual data; it was only applied to the forecast expenditure.
- 29) The application of an on-going efficiency challenge only makes sense when there is a possibility for the DNOs to find more efficient ways of undertaking the work.
- 30) The attached model calculates a unit cost for each disaggregated permit condition. The model excludes volumes where no cost is attributed to the volume as these volumes are clearly not a driver of cost. The model establishes a benchmark average unit cost across all DNOs across M9b, M9c and M9d in aggregate, consistent with the permit and admin unit cost calculation. The benchmark unit cost is then applied to the individual DNO volumes (excluding volumes with no cost) to establish a benchmark modelled cost for each DNO for each year.
- 31) This is then combined with a modelled cost for the permit and administration costs as was calculated in Ofgem’s original model and the remainder of the calculation is unchanged except for removing the efficiency as per our comments above.
- 32) Ofgem has applied the materiality thresholds consistently with the decision in 2019 and only applied them to each licensee once, which is correct.

## 4. Net to Gross

- 33) NPgN and NPgY were within the percentage thresholds for this test and therefore have no proposed adjustments.
- 34) The method used and underpinning logic of the calculation appears reasonable. However, as set out in our response to NPg SQ11 (shown below) following due consideration of the calculation; this would not be our preferred method:

*“Our approach for calculating ‘specific customer funded reinforcement’ equates to the income from Rows 140 and 141 of Table ‘C2 – Connections’, with the income relating to Indirects from cell E60 of Table C1 deducted.*”

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*In response to the question we can understand the logic of instead picking up the values from Row 134 and 135 of Table 'C2 – Connections' which detail the relevant direct costs.*

*Both approaches are set out in the attached spreadsheet, and for both approaches we remain below the upper threshold for each licence”.*

## 5. Network Asset Secondary Deliverables (NASDs)

- 35) Section 5 explains Ofgem’s proposed adjustments for secondary deliverables within the RIIO-ED1 period. We agree that both the NPgN and NPgY have delivered their respective Network Asset Secondary Deliverable (“NASD”) targets.
- 36) In reaching its position, Ofgem did not require any additional data to that provided as part of the 2023 RRP submission or clarity of any of the submitted data or reports including the RIIO-ED1 performance report. This is a positive outcome and provides us with assurance that the NOMs framework as a whole is providing sufficient data and information on which Ofgem is able to fulfil its own assessment process as outlined in its Closeout Methodologies Decision. This is important as we look to continually improve the framework through its evolution into NARMs including for RIIO-ED2 closeout and for ED3.
- 37) In reaching this outcome Ofgem has specified that upper and lower materiality thresholds were used when assessing compliance with the overall network target (also known as a deadband) and that the deadband was set at +/-5% of the target. We worked with Ofgem on the development of the deadband to ensure the assessment process is proportionate whilst recognising the reasonable changes that may occur during a period, albeit Ofgem waited until it had seen the results before setting the detailed elements. We welcome that Ofgem has, for RIIO-ED2, specified the deadband ahead of the price control period rather than after the period.

## 6. Link Box

- 38) We have no significant comments or material representations to make with regard to the approach to the Link Box reopener. NPgN and NPgY sought no adjustment and we have no issues with the approach taken.