

# Decision

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## **RIO-2 Tier 1 Stubs Repex Policy Re-opener Final Determinations**

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This document sets out our decisions on two Tier 1 Stubs Repex Policy Re-openers that were submitted in October 2023 and March 2024 by SGN and Cadent respectively. These were submitted under Special Condition (SpC) 3.18.

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## **1.Introduction**

### **What did we consult on?**

- 1.1 SGN and Cadent applied to Ofgem to add additional allowances into their RIIO-2 price control frameworks under the Tier 1 Stubs Repex Policy Re-opener (SpC 3.18).
- 1.2 Following their submissions, the licensees also provided additional information to us through a combination of bilateral meetings and Supplementary Question (SQ) responses.
- 1.3 We considered each proposal and the relevant justification for the funding requested in accordance with our principal objective and statutory duties. In line with the [Re-opener Guidance and Application Requirement Document](#), our assessment covered the following three areas for each project:
  - the needs case,
  - the options assessment and the justification for the proposed project,
  - the efficient costs for the proposed project.
- 1.4 We combined this information to create our Draft Determinations on what additional allowances, if any, should be provided to each licensee to undertake the relevant projects.
- 1.5 We issued a consultation on our Draft Determinations between 7 November 2024 and 5 December 2024, and included a draft of the direction that would be used to implement the Draft Determination. We received two responses.

### **Purpose of this document**

- 1.6 This document summarises the consultation responses received from stakeholders, and an explanation of the changes made, if any, to our Draft Determination position since the consultation. It also sets out our Final Determinations for applications submitted under the re-opener.
- 1.7 Alongside this decision, we are publishing a direction to amend SGN and Cadent’s licence for this decision.
- 1.8 We are also publishing a statutory consultation to implement our decision to assign Price Control Deliverables (PCDs) as part of our Final Determinations. This consultation will run from 7 February 2025 to 7 March 2025 and we welcome responses on the proposed licence modifications.

## Related publications

1.9 This document is intended to be read alongside:

- [Re-opener Guidance](#),
- [Licence Special Conditions](#) – licenses available on the Electronic Public Register,
- Gas Distribution Network (GDN) applications: [SGN](#) and [Cadent](#),
- [Draft Determinations](#).

## Summary of our Final Determinations

1.10 **Table 1** below summaries our Draft and Final Determinations for the Tier 1 Stubs Repex Policy Re-opener. Chapters 2-3 discuss these in greater detail.

**Table 1: Summary of our Draft (DD) and Final Determinations (FD) (£m, 18/19 prices)**

<b>Sector Group</b>	<b>Network</b>	<b>Re-opener cost request</b>	<b>Ofgem's DD allowances</b>	<b>Ofgem's adjustment DD to FD</b>	<b>Ofgem's FD allowances</b>
Scotia Gas Networks	Sc	0.65	0.00	+0.42	0.42
Scotia Gas Networks	So	3.10	0.00	+1.52	1.52
Cadent	EoE	4.77	3.70	+0.95	4.65
Cadent	Lon	3.80	2.74	+0.59	3.33
Cadent	NW	7.65	6.58	+0.38	6.96
Cadent	WM	6.38	5.31	+0.60	5.91

## **2.Common considerations and decisions**

### **Needs case and optioneering assessment**

#### **Summary of our Draft Determinations**

- 2.1 Our Draft Determinations concluded that applications under the re-opener presented a succinct needs case which outlined necessary network activities under the [Iron Mains Replacement Programme \(IMRRP\)](#) mandated by the Health and Safety Executive (HSE). Furthermore, the work would aim to keep the gas pipeline network running safely and efficiently in accordance with obligations under the Pipeline Safety Regulations 1996 (PSR).
- 2.2 Our Draft Determinations also outlined appropriate optioneering has been considered to address the needs case.

#### **Responses to our Draft Determinations**

- 2.3 We received responses from SGN and Cadent. Both supported our proposals to approve the needs case and optioneering for these re-opener applications.

#### **Our Final Determinations**

- 2.4 Our Final Determination is to approve the needs case and optioneering for these re-opener applications.

### 3. Cost assessment

#### SGN

3.1 **Table 2** below highlights our Draft and Final Determinations for SGN’s Tier 1 Stubs Repex Policy Re-opener.

**Table 2: Summary of our Draft (DD) and Final Determinations (FD) for SGN’s Tier 1 Stubs Repex Policy Re-opener (£m, 18/19 prices)**

Network	SGN Re-opener costs	SGN baseline allowance <sup>1</sup>	Ofgem’s DD allowances	SGN updated Re-opener costs	SGN Updated Re-opener request	Ofgem’s adjustment from DD to FD	Ofgem’s FD allowances
Scotland	1.81	-1.16	0.00	1.58	0.42	+0.42	0.42
Southern	5.63	-2.53	0.00	4.05	1.52	+1.52	1.52
<b>Total</b>	<b>7.44</b>	<b>-3.69</b>	<b>0.00</b>	<b>5.63</b>	<b>1.94</b>	<b>+1.94</b>	<b><u>1.94</u></b>

#### Our Draft Determinations

3.2 We proposed an overall downwards adjustment of £3.69m for the following:

- Unit costs.

We proposed to award no additional funding under SGN’s re-opener application as our analysis, using SGN’s unit costs at RIIO-2 Business Plans (BPs), demonstrated that SGN already had sufficient baseline allowance to remediate its proposed volumes in its re-opener application.

#### SGN’s response to our Draft Determinations

3.3 SGN did not agree with our cost assessment and proposed draft allowances. SGN argues that maintaining allowances based on the RIIO-GD2 Final Determinations is not conducive to a productive stubs remediation programme. When RIIO-GD2 BPs were submitted, Tier 1 stubs were an emerging issue with costs, scope and remediation strategy all subject to ongoing external assessment. As such, unit rates and cost estimated would be subject to later refinement. The DNV study, carried out by consultancy firm DNV on behalf of the GDNs, was completed after

<sup>1</sup> [RIIO-2 Final Determinations – SGN Annex \(REVISED\)](#) – page 46, paragraph 3.52. At FDs, we awarded £1.16m and £2.53m for the Scotland and Southern networks respectively. SGN’s application states £1.2m and £2.4m were awarded for Scotland and Southern networks respectively. We have referenced our FD decision numbers in this document.

RIIO-GD2 BP submission, which helped confirm the population of stubs eligible for remediation and therefore programme workloads.

- 3.4 During the consultation period, SGN has included detailed case studies which highlighted stub remediation work can retrospectively change during excavation and therefore increasing the associated remediation costs. For example, a stub could be in a different location or require alternative remediation due to different material or size to what was expected.
- 3.5 SGN also argues that its stubs programme excludes excavations where little or no remediation would likely be required. SGN highlights this shortlisting programme removed approximately half of the potential stubs population; if all stubs were included then average unit rates would be materially lower. SGN also adds that its unit costs are comparable to other GDNs when considering Regulatory Reporting Pack (RRP) returns against awarded allowances.
- 3.6 As part of its consultation response, SGN has also included refined costs based on latest available data which has reduced its total re-opener cost request. These are highlighted in **Table 2** above. SGN's programme workload remains the same from its original re-opener application in October 2023.

### **Our Final Determinations**

- 3.7 We agree with the consideration raised by SGN that when RIIO-GD2 BPs were submitted, much was still unknown about the stubs work programme. We acknowledge that, as more information became available, costs and workload volumes were refined as a result.
- 3.8 We consider SGN's targeted approach to stubs to be in consumers best interest, where only necessary remediation work is carried out. This ensures costs incurred are a true reflection of required work, rather than costs which appear lower on a per-unit basis for a less focussed approach. We acknowledge that omission of stubs not requiring intervention can appear to inflate unit costs and have compared this to recent RRP submissions from other GDNs.
- 3.9 Our Final Determination is to award an additional allowance, based on SGN's updated cost information, of £1.94m on the basis that there is now more certainty around unit costs and remediation costs. This also represents a lower re-opener funding request from SGN compared to its original re-opener application in October 2023. We consider SGN's costs to be efficient and focus only on necessary remediation work. The Tier 1 stubs work is a requirement under the IMRRP, with cost efficient maintenance of gas pipelines to be in consumer's best interest.



PCDs

3.10 We have decided that a PCD associated with Tier 1 stubs allowances is appropriate as it better mitigates consumers’ risk of under-delivery.

- Tier 1 Stubs Remediations:

(1) Scotland network: Total RIIO-GD2 allowance of £1.58m (£1.16m baseline allowance and £0.42m re-opener allowance) to remediate 152 stubs, average unit cost of £10,395/stub,

(2) Southern network: Total RIIO-GD2 allowance of £4.05m (£2.53m baseline allowance and £1.52m re-opener allowance) to remediate 225 stubs, average unit cost of £18,000/stub.

**Cadent**

3.11 **Table 3** below highlights our Draft and Final Determinations for Cadent’s Tier 1 Stubs Repex Policy Re-opener.

**Table 3: Summary of our Draft (DD) and Final Determinations (FD) for Cadent’s Tier 1 Stubs Repex Policy Re-opener (£m, 18/19 prices)**

<b>Activity</b>	<b>Cadent re-opener costs</b>	<b>Ofgem’s DD allowances</b>	<b>Ofgem’s adjustment from DDs to FDs</b>	<b>Ofgem’s FDs allowances</b>
Stub remediations	14.71	12.72	+1.86	14.58
On-site assessments	7.90	5.61	+0.65	6.26
<b>Total</b>	<b>22.61</b>	<b>18.33</b>	<b>+2.51</b>	<b><u>20.84</u></b>

**Our Draft Determinations**

3.12 We proposed an overall downwards adjustment of £4.28m for the following:

- Unit costs,
- Overheads rates.

We also proposed a PCD to protect consumers from under-delivery.

**Cadent’s response to our Draft Determinations**

Unit costs

3.13 Cadent disagreed with our proposed approach in applying the unit rate provided for NGN at RIIO-GD2 Final Determinations (£8,200/stub). Cadent has argued that NGN’s baseline allowance of £11.68m included a combination of stub remediation

and stub not found identification. In comparison, Cadent's re-opener request solely relates to the remediation of stubs. Cadent has claimed, based on RRP submissions, that NGN is receiving a significantly higher unit rate for remediating stubs as the majority of stubs are not found and therefore not remediated. Therefore, Cadent highlights that its proposed £9,400/stub is significantly lower and provides evidence to demonstrate that it is an efficient cost.

Attributed overheads rates for on-site assessments

3.14 Cadent disagreed with our proposal to reduce its 15% attributed overheads rate to 11% in line with our recent Draft and Final Determinations for other RIIO-GD2 re-opener submissions submitted in 2024.

3.15 Cadent argues that its internal finance guidance categorises these as overheads but traditionally these costs would be classified as direct costs relating to:

- Project supervision and operational management,
- Project planning and programming,
- Where applicable, data capture, environmental, and reinstatement specialists.

Cadent states that the 15% rate is consistent across all Repex work and formed part of its cost base which set the industry benchmark at RIIO-2. Cadent therefore considers this rate to be efficient.

3.16 Cadent also highlighted calculation errors within our Draft Determinations which resulted in a £0.62m shortfall in allowance.

Allocated overheads rates for on-site assessments

3.17 Cadent disagreed with our proposal to disallow its estimated 25% of allocated overheads on the basis that we did not see sufficient evidence of a direct relationship between additional Tier 1 Stubs work and these overheads.

3.18 Cadent argues that these functions have not been funded through baseline as it has no baseline allowance for stubs, and that therefore these elements have not been accounted for. Cadent also added that standard economic theory explains in the case of semi-variable and variable costs, as the level of direct work increases, semi-variable costs will also rise to support the delivery of the activity.

**Our Final Determinations**

Unit costs

3.19 We have decided to increase Cadent's unit costs from £8,200/stub to £9,400/stub as per Cadent's original re-opener application. We acknowledge that NGN's

awarded unit costs from RIIO-GD2 are not comparable to current re-opener applications. NGN's workload covers both stub remediations and stubs which are not intervened on, compared to Cadent and SGN's applications which only cover stub remediations. Our Final Determination is to award £14.58m for stub remediations.

Attributed overheads rates for on-site assessments

3.20 We have decided to maintain our Draft Determinations position and award an 11% attributed overheads rate as per previous re-opener Final Determinations. Whilst Cadent has explained how it calculates this rate, it did not provide sufficient evidence to demonstrate that our Draft Determinations rate of 11% omitted any activities for which it will incur additional costs as a direct result of additional Tier 1 Stubs remediation work.

3.21 We have also updated our allowance calculations to amend minor errors flagged by Cadent. These are included in **Table 3** above.

Allocated overheads rates for on-site assessments

3.22 We have decided to disallow Cadent's 25% allocated overheads rate. Cadent has explained that it did not receive a Tier 1 stubs baseline allowance and referenced standard economic theory to explain why there should be a direct relationship between central business functions costs, such as IT, HR and finance, and increased Tier 1 stubs work. However, we have not seen sufficient evidence of a direct relationship between additional Tier 1 Stubs remediation work and increases in the costs associated with these central business functions.

PCDs

3.23 Cadent did not disagree with our Draft Determinations proposal to set a PCD for the allowance. Our Final Determination is to confirm the following PCD:

- Tier 1 Stubs Remediations – 1551 stubs to be remediated in RIIO-GD2 with a unit cost of £9,400/stub. Associated allowance: £14.58m.