

Cost Assessment Working Group (CAWG): 10 May 2012

The second meeting of the CAWG to inform cost assessment for RIIO-ED1.	From Date and time of Meeting Location	Sara McGonigle 10 May 10-3.30pm UKPN, London	11 May 2012
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1. Present

- Andrew Stanger, Scottish Power
- John Gray, Scottish Power
- Bob Parker, Western Power Distribution
- Barry Hollinghurst, Western Power Distribution
- Sarah Walls, Electricity North West
- Jonathan Booth, Electricity North West
- Julian Rudd, UK Power Networks
- Keith Mawson, Northern Powergrid
- Iain Miller, Northern Powergrid
- Mark Kelly, Scottish and Southern Energy
- Kenny McAllister, Scottish and Southern Energy
- James Hope, Ofgem
- Mark Hogan, Ofgem
- Sara McGonigle, Ofgem

2. Apologies

- 2.1. Helen Inwood, NPower

3. Update on Actions

3.1. The meeting began with an update on actions from the last meeting, beginning with Ofgem actions. In this discussion, the scenarios in the July forecast pack were raised. For information, James Hope (JH), Ofgem, welcomed any comments from the DNOs on the structure of that (ie the July pack with a separate attachment on scenario template) and any comments on the level of detail. Thoughts currently are now looking towards basing the scenarios upon Workstream 1 ahead of workstream 3 but Ofgem will write and confirm this. The scenarios are there to give a high-level indication and are not to be viewed as prescribing the scenario that DNOs should adopt in their May Business plan.

3.2. It was noted by JH that there were a range of views on the scenarios from the Flexibility and Capacity Working group (FCWG) but as yet no firm views on the specification of the scenarios.

3.3. Bob Parker (BP), WPD, noted that the base case for each DNO is likely to be different (one DNOs low case, is another's high case scenario).

3.4. In response JH also confirmed that comparisons of forecast scenarios will take place next year and this year the forecasts are for visibility purposes only. JH further confirmed that:

- a ninth year was added the forecast pack in light of the decision yet to be made on whether ED1 will be an eight or nine year price control
- the scenarios would be expected for table C1 of the RIGs
- the scenarios are expected any time before 20th December 2012.

3.5. JH would confirm this in a note and respond to an email sent by Sarah Walls (SW) of ENWL copying in all the other DNOs.

3.6. Sara McGonigle (SM), Ofgem, noted that for two key actions points on the DNOs (thoughts on Business Support Costs (BSCs) and use of external consultants), only a small number replied. DNOs agreed to provide feedback on these points.

3.7. Regarding BSCs, JH agreed that Ofgem colleagues (Martin Rogers and Neill Guha) will provide guidance on what will and will not be available in the public domain regarding work completed by consultants and Ofgem in this area. This will be circulated to the DNOs.

3.8. Keith Mawson (KM), Northern Powergrid, provided some wording on RPEs that was put into the RIGs pack. It was stressed that this was for the July submissions only and needs revising. Andrew Stanger (AS), Scottish Power, noted that he would welcome further refinement of this.

3.9. Regarding the action on DNOs of what constitutes a well justified business plan (WJBP) there was some discussion on what had been covered on the FCWG. John Gray (JG), Scottish Power, noted that at the meeting there were a few slides with different perspectives but it didn't concern the cost assessment element of a WJBP.

3.10. There was some confusion on what the action meant and it was agreed that what it should be is the views are on what the cost assessment element of the business plan (ie the tables) should cover. This was agreed by all parties and the action will be changed accordingly.

Action	Who	By
DNOs to provide feedback to Ofgem on the scenario worksheet that was sent out with the July forecast pack.	DNOs	24 May 2012
Ofgem to provide further guidance on the scenarios and respond to email sent by Sarah Walls of ENWL (copying in other DNOs).	JH	15 May 2012
Ofgem to provide guidance on the elements of the BSCs that will/will not be in the public domain.	SM	TBC ¹
DNOs will provide their scenarios forecasts no later than 20 December 2012.	DNOs	20 Dec 2012

¹ SM has emailed Martin Rodgers and Neill Guha on when this would be possible.

4. Meeting Plan

4.1. Comments on the meeting plan from the DNOs at the beginning of the meeting were:

- that there was a lot to get through
- that some areas are best moved to WG4 as BP and Barry Hollinghurst (BH), WPD, could not make WG3
- that BSCs should be in the column not in the row – KM raised this point along with it being moved in the terms of reference. JH assured the DNOs that this certainly did not diminish the importance of BSCs, but it made sense to put it as a main agenda item for WG5 (10 July).
- KM also raised a query regarding why QoS, Guaranteed Standards and IIS were all on the CAWG's agenda. It was acknowledged by JH that there is an awkward cross over between the CAWG and the Reliability and Safety Working Group (RSWG) in this area. However, the CAWG will only deal with the financial side of things – looking at all issues in table C1. As JH sits in both groups, it is likely that any cross over would be minimal. Mark Kelly (MK), SSE, noted that the RSWG should inform the CAWG.

4.2. At the end of the meeting, there were concerns that what should have been covered in the meetings to date was not covered in sufficient detail; that the CAWG so far has been sticking to high level principles as opposed to getting to the detail. It was acknowledged that getting the principles right was critical but the next meeting should begin to cover the detail.

4.3. In light of this, for the next meeting, that has network operating costs (NOCs) on the agenda, WPD agreed to benchmark the 2010/11 returns. While BP and BH will not be at the meeting, a colleague will be able to attend. This will ensure getting into the detail of the issues on the agenda.

4.4. SW went back to the meeting plan and sought detail on the technicalities of assessing whole life costs. Ofgem agreed to provide further detail on this.

4.5. SW also noted that innovation was on the agenda and not covered. However, JH responded by stating that this was really a key area for the innovation working group and not a key theme for the CAWG. It will come up in a number of issues as we get into the detail, but innovation in itself is not a key issue for this group.

4.6. The key question put to the group by JH was what do they want to see in the September paper and we can work back from then. BP sought:

- a good description of the toolkit
- that the specification was (more or less) set by then
- that the models were in place
- that the July data can be used to test the model.

4.7. Ofgem appreciated the constructive feedback and reiterated that the purpose and pace of the CAWG was the responsibility of the whole group. Ofgem agreed that the group will now consider the detail and in doing so, any future presentations must include the numbers.

4.8. By Thursday 17th May, the DNOs were asked to email Ofgem with more detailed feedback on the plan - what should be covered, when it should be covered, in what level of detail and what they would like to achieve by the end of each meeting.

4.9. It was further asked if there was merit in continuing the CAWG post September. JH noted that no decision has yet been made in Ofgem regarding the continuation of the RIIO-ED1 groups, but noted that he can see merit in this group continuing. It was also noted that, although not in the schedule, it may also make sense to have one prior to the publishing of the September paper.

Opt in Principle

4.10. An action from the last meeting was for Ofgem to provide greater clarity on the opt-in principle to DNOs (ie once fast tracked could the DNOs move back to slow track). It was put to the DNOs that once a company is fast-tracked it cannot opt back in to slow track (to accrue any benefits that they will not receive but slow-tracked companies may accrue). The rationale is that any rewards from being fast-tracked would outweigh any rewards to a slow-track company.

4.11. DNOs were still concerned about how this would pan out in practice – this is the idea of the “no worse off principle”. The Information Quality Incentive (IQI) must be such that it will always be larger than the potential out performance of the slow-track companies.

4.12. BP suggested that Ofgem need to be alive to this issue and have a mechanism to deal with it. For instance, AS noted an example regarding the cost of debt – and how this may differ over the different periods the stem the fast-track and slow-track processes.

4.13. JH committed Ofgem to answer this more fully following internal discussions. It is likely that this would be an Authority decision. The decision will be no later than the September document, but hopefully before then. DNOs expressed a preference to have this in advance of the September document.

Action	Who	By
Ofgem to provide further detail on how to assess whole life costs.	JH	26 June 2012
How would licensees put forward a justification of lowest whole life cost?	DNOs	26 June 2012
DNOs to email Ofgem with more detailed feedback on the meeting plan (what should be covered, when it should be covered, in what level of detail and what they would like to achieve by the end of each meeting).	DNOs	17 May 2012
Ofgem to provide further detail on how the no worse off principle will operate in practice.	JH	No later than September paper

5. Totex Presentations

5.1. Three totex presentations were given to the group - by UKPN, SSE and a joint presentation from ENWL and WPD. All agreed that the slides can go on the Ofgem website.

5.2. BP also requested that Ofgem attach documents to any emails sent rather than simply the link. Ofgem agreed to do this.

5.3. Key comments raised during the SSE presentation were that:

- The incentive mechanism is critical to rewarding frontier companies – this was a key issue for SSE (and for all DNOs).

- JH noted that Ofgem would like to be in a position that favours *ex ante* allowance, rather than relying on uncertainty mechanisms. DNOs were in favour of this.
- Regarding incentivising and rewarding frontier companies, there must be something tangible from the DNOs that demonstrate that they have completed certain things – outputs are critical and it is important to monitor the outputs in going forward, ie what is actually being delivered. A mechanism for ED1 needs to be developed for this.
- Critical to any business plan is justification for what the DNO is planning to do and what it will cost.
- BP noted that “smart” does not always mean “innovative” but DNOs should consider this as meaning “to do the right thing”. SSE agreed with this proposition.

5.4. Key comments raised during ENWL and WPD presentations were as follows:

- The two DNOs were about 90% in agreement on issues and there was 10% that needed further debate.
- JH asked that of all the lists of activities that WPD/ENWL stated should be in totex, what value of total revenue did this account for. BP estimated 90-95% - while this was an estimate he supported this by noting that there really needed to be a good reason for excluding items from Totex.
- MK noted that while the model was reliable for WPD that does not mean it is the right model for other DNOs, and while acknowledging the significant efficiencies made by WPD in its purchase of central networks, MK also stated that it is possible that further efficiencies may have been made.
- JH responded that Ofgem will not necessarily adopt one approach on totex by one DNO/group of DNOs. It is more likely that the Ofgem model will comprise of different parts from a number of models, influenced by its own work as well as that of the DNOs. Further, JH noted that there is nothing in the RIIO handbook that prohibits Ofgem making use of a number of models and testing different models with the numbers.
- BP further supported the WPD model on the basis that it used logical cost drivers and not proxies.

5.5. The WPD/ENWL presentation detailed what they believed should/should not be in the totex model (from the activities in C1). WPD and EMWL were in agreement on most, not all of these.

5.6. KM and Kenny McAllister (KMCA), SSE, noted that the WPD model does not avoid trade-offs. This was acknowledged by BP, but BP stated that these trade-offs are significantly reduced and less immune to cherry-picking than previous models.

5.7. KM further explored and it became clear that the trade-off is reduced because the average is taken as the benchmark rather than upper quartile. It is not therefore the approach that is reducing the trade-off but the level of benchmark. Indeed the reduction in trade-off is approximately 25%.

5.8. To explore this further, JH suggested using 2010/11 data in the WPD model for the next totex meeting (26 June 2012). There was consensus that until the numbers are put through the model, it is difficult to critically review it (an issue raised by MK). BP and BH agreed to do so.

5.9. KM stated that the WPD model is not a totex model (as envisaged by the RIIO handbook) and was an aggregate of a disaggregate model. BP did not disagree with this but stated that this was really the best way to do it to ensure realistic cost drivers are used.

5.10. JH noted that while this was not totex in its “purest” sense, there is an opportunity for the DNOs to present their model(s), their interpretation of totex and justify it accordingly. Ofgem will review and critique all approaches.

5.11. KM noted that he may have some definitional issues with the model and welcomed a discussion on these. An action was subsequently placed on the DNOs to decide what activities should be in or out of totex (giving consideration to their rationale for this).

5.12. MK again raised a concern that until the model is tested with numbers, this is difficult to do. Therefore, it was agreed that WPD would endeavour to populate the model by 31 May 2012 with 2010/11 data. If this is not possible, WPD will use 2008/09 data in an earlier version of the model. This will then be emailed to the group who will have until 14 June 2012 to comment on the model, critiquing what should be in or out.

5.13. Ofgem will pull together the comments for discussion on 26 June 2012.

5.14. JH opened it to the group that sharing and critiquing any models (not just WPD) would be constructive.

Action	Who	By
DNOs to provide feedback on the DNO Totex presentations.	DNOs	24 May 2012
To put the 2010/11 data into the WPD totex model and report to all the group. If not feasible in timescale, an earlier version of the WPD model will be populated with 2008/09 data.	BP and BH, WPD	31 May 2012
To critique the model in light of the numbers.	DNOs	14 June 2012
Ofgem to collate the comments on the critique of the WPD totex model.	JH, SM, MH	26 June 2012
To present the numbers and comparison at the next totex meeting (26 June 2012).	BH and BP	26 June 2012

6. Network Investment

6.1. It was acknowledged that the effort on the DR5 RIGs have meant that a lot can be taken from DR5 and replicated in ED1. That said, there are number of areas that need to “bottomed out”.

6.2. First, the discussion turned to outputs and how a consistent definition of outputs is reached. It was acknowledged that Ofgem and the DNOs should have this in place for ED1. This would not be done by September – it is too ambitious a task.

6.3. It was acknowledged that some of the activities easily lend themselves to unit costs and there was agreement not to over-complicate things (if it isn’t broke..).

6.4. Iain Miller (IM), Northern Powergrid, stated that the problem to be solved should always be the general approach. If it is a simple case where the solution is a yes/no answer (ie should an installation take place or not), then defining the outputs are clear. However, the issue lies when there are different solutions to a problem.

6.5. This generated a debate on whether the focus is on solving the problem or on the solution.

6.6. The focus on a solution was a central part of SSE’s point that a company should be rewarded for undertaking a “smart” solution (in the widest sense). A critical question that remains is how DNOs get awarded for a more efficient solution to a problem. There are 3 outcomes to an identified issue:

1. Not to deliver at all
2. To deliver efficiently
3. To deliver inefficiently.

6.7. It was argued that a distinction between 2 and 3 is critical in RIIO, given the objective of ensuring costs are "efficient costs".

6.8. MK agreed to suggest something on this for the next meeting. However, there was some debate on whether this was the area for the RSWG or for the CAWG. JH and MK agreed to have an off-line discussion on this. Sarah Walls (SW), Electricity North West, noted that it did not matter which group as long as it was communicated to both sufficiently. MK/SSE agreed to pick up this issue at the next LI meeting.

6.9. JH noted that while RIIO pushes licensees to think innovatively, there should not be an incentive to choose a "smart" solution over a "conventional" solution, but instead it should be the case that whatever choice is made it must "wash its face". That is the DNO should state why this is the most efficient solution to a problem/to achieving an output. Ofgem will recognise this and question why other DNOs are not adopting the most efficient solutions that other DNOs are adopting.

6.10. MK noted that there was not an efficiency test in the LI. The group agreed and JH noted that there will a lot of work that will need to be done to develop a metric that picks up these issues.

6.11. An action was placed on the DNOs was to note, from all the activities in C1, what is fit for purpose, what requires minimal tweaks (what and why) and what needs wholesale change. This will give the group something to get into the detail of.

6.12. BP noted that one area needing wholesale change is reinforcement of circuits - as we move to low carbon this will feature more and more. BP also noted that we must distinguish between what may be fit for purpose but in fact could be improved.

6.13. This led to the issue of whole life costs and efficiency – which may be in conflict. Therefore, it is important to decide how long costs should be spread over.

6.14. Both MK and SW acknowledged that the real options paper may feed into this and that the group will benefit from the presentation on this.

6.15. DNOs agreed to feedback to Ofgem on their view on how long forecasts need to be made to ensure the business plans are well justified– is ED1 enough? Should we move to ED2? Start from 2050 and work back? It was acknowledged that the further forward projections are made, the less accurate.

6.16. On this, Jonathan Booth (JB), ENWL, noted that this raises the question of whether ED1 is a continuation of DPCR5 or the first phase of ED2. The view taken will depend on what each DNOs plans are but if different approaches are taken when numbers are put through a common model, it will be the case that the numbers are not comparable. Ofgem need to be aware of this.

6.17. Julian Rudd (JR), UKPN, reiterated a point in his presentation on the issues - it comes down to the DNOs justification in the business plan and BP noted that this is in fact no different to any other past price control.

6.18. There was acknowledgement that this is a difficult task nonetheless. If ED1 is seen as first phase of ED2, 3 etc, it might make sense to put a larger transformer in than is required for ED1 as the view of the ED2 and ED3 period is that it will be required then.

However, in the meantime, there is excess load on the network, leading to financial penalties. This is a difficult challenge for the DNOs. The conclusion was that whole life cost approach makes sense, but perhaps not for load.

Action	Who	By
JH and MK agreed to have an off-line discussion on where best to debate the issue of most efficient solutions.	JH and MK	14 June 2012
MK/SSE to raise the issue at the next LI meeting.	MK/SSE	14 June 2012
To confirm that date that James Grayburn will present at the CAWG.	SM	14 May 2012
DNOs agreed to feedback to Ofgem their views on the length of future forecasts.	DNOs	24 May 2012

7. CAWG Date of next meeting

7.1. The next meeting will take place on 29 May in Energy Networks Association, 52 Horseferry Road, London.

8. Consolidated list of actions

8.1. The table below provides a consolidated list of actions from Meeting 1 and meeting 2.

Action	Person	Date	Complete?
Ofgem			
Remove Scenarios from C1 in Forecast pack.	MH	1 May 2012	✓
Ofgem to provide in the minutes a link to the Dartford Determination consultation document.	SM	1 May 2012	✓
Ofgem to circulate with the minutes comments on costs assessment issues in response to the RIIO-ED1 launch letter.	SM	1 May 2012	✓
Ofgem to circulate the links to the options value model being used in RIIO-GD1 with the minutes.	SM	1 May 2012	✓
Ofgem to circulate a redraft of the TOR and submitted comments on the TOR.	SM	4 May 2012	✓
Ofgem to pull together a straw-man of meeting topics.	JH	4 May 2012	✓
Ofgem will arrange with James Grayburn to present on the options value model in one of the CAWG meetings.	JH	4 May 2012	✓ (26 June)
Ofgem to add delete the area in the forecast pack regarding scenarios and add it in separate table for visibility purposes only.	MH	4 May 2012	✓

Ofgem to find out from Bill McKenzie which working group will be dealing with the issue of pension ² deficits.	SM	4 May 2012	!
Ofgem to provide greater clarity on the "opt-in" principle.	JH	10 May 2012	! Done but more on no worse off to come
Ofgem to provide greater levels of commentary in the tables and for decisions made.	C&O team	ongoing	
To engage with colleagues to inform them of a preference of three scenarios.	Ofgem and DNOs	ongoing	
Ofgem to provide guidance on the scenarios.	JH	Within 1 month of WS3 report	
To confirm that date that James Grayburn will present at the CAWG.	SM	14 May 2012	✓
Ofgem to provide further guidance on the scenarios and respond to email send by Sarah Walls of ENWL (cc'ing in other DNOs).	JH	15 May 2012	✓
Ofgem to provide guidance on the elements of the BSC that will/will not be in the public domain.	SM	TBC	✓
JH and MK agreed to have an off-line discussion on where best to debate the issue of most efficient solutions.	JH and MK	14 June 2012	
Ofgem to provide further detail on how to assess whole life costs.	JH	26 June 2012	
Ofgem to collate the comments on the critique of the WPD totex model.	JH, SM, MH	26 June 2012	
Ofgem to provide further detail on how the no worse off principle will operate in practice.	JH	No later than Sep paper	
DNOs			
DNOs to provide to Ofgem through email their thoughts on totex (ElectricityDistribution.CostsandOutputs@ofgem.gov.uk).	DNOs	4 May 2012	✓
DNOs to come back to Ofgem to state willingness to present thoughts on totex at the next meeting.	DNOs	4 May 2012	✓
DNOs to give thought prior to next meeting on further iterations of assessing BSCs (email ElectricityDistribution.CostsandOutputs@ofgem.gov.uk).	DNOs	10 May 2012	!
DNOs to provide to Ofgem their thoughts on areas	DNOs	10 May	!

² The pension issue relates to both on-going costs and incremental deficits and is still open.

that would merit use of external consultants by email ElectricityDistribution.CostsandOutputs@ofgem.gov.uk .		2012	
Keith Mawson to provide an email proposing some words re RPEs to facilitate consistency in submissions.	KM	10 May 2012	✓
DNOs to comment and feedback to Ofgem on what the cost assessment element of the WJBP should comprise.	DNOs	ongoing	
To engage with colleagues to inform them of a preference of three scenarios.	Ofgem and DNOs	ongoing	
DNOs to email Ofgem with more detailed feedback on the Meeting plan (what should be covered, when it should be covered, in what level of detail and what they would like to achieve by the end of each meeting).	DNOs	17 May 2012	
DNOs to provide feedback on the DNO Totex presentations.	DNOs	24 May 2012	
DNOs agreed to feedback to Ofgem their views on the length of future forecasts	DNOs	24 May 2012	
DNOs to provide feedback to Ofgem on the scenario worksheet that was sent out with the July forecast pack.	DNOs	24 May 2012	
To put the 2010/11 data into the WPD totex model and report to all the group. If not feasible in timescale, an earlier version of the WPD model will be populated with 2008/09 data.	BP and BH, WPD	31 May 2012	
To critique the model in light of the numbers.	DNOs	14 June 2012	
JH and MK agreed to have an off-line discussion on where best to debate the issue of most efficient solutions.	JH and MK	14 June 2012	
MK/SSE to raise the issue at the next LI meeting.	MK/SSE	14 June 2012	
To present the numbers and comparison at the next totex meeting (26 June 2012).	BH and BP	26 June 2012	
How would licensees put forward a justification of lowest whole life cost?	DNOs	26 June 2012	
DNOs will provide their scenarios forecasts no later than 20 December 2012.	DNOs	20 Dec 2012	