

Cost Assessment Working Group (CAWG): 26 April 2012

The first meeting of the CAWG to inform cost assessment for RIIO-ED1.	From Date and time of Meeting Location	Sara McGonigle 26 April 10-4pm Ofgem, Millbank	1 May 2012
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1. Present

- Andrew Stanger, Scottish Power
- Stuart Reid, Scottish Power
- Ruth Crascall, Western Power Distribution
- Dawn Broderick, Western Power Distribution
- Bob Parker, Western Power Distribution
- Sarah Walls, Electricity North West
- Julian Rudd, UK Power Networks
- Keith Mawson, Northern Powergrid
- Mark Kelly, Scottish and Southern Energy
- Kenny McAllister, Scottish and Southern Energy
- James Hope, Ofgem
- Mark Hogan, Ofgem
- Sara McGonigle, Ofgem
- Lawrence Irlam, Ofgem
- Martin Rodgers, Ofgem
- Neil Guha, Ofgem

2. Apologies

- Helen Inwood, NPower

3. Introduction – RIGs responses

3.1. The meeting commenced with a discussion on the DPCR5 RIGs.

Scenarios

3.2. Scenarios were a key concern for the licensees and an area in which electricity distribution network operators (DNOs) sought further guidance. In particular, the definition of each scenario and what level of reporting is required for each.

3.3. The current Frontier work being conducted as part of Workstream 3 of the Smart Grids Forum was quoted as being able to provide core carbon scenarios, which is likely to be in July, although the date is not finalised.

3.4. Discussions centred on the number of scenarios (A, B, C?), if a scenario should include a “best view” scenario requiring justification from each DNO, or a “business as usual” scenario. Ofgem agreed that it would provide more guidance on this.

3.5. In the meantime the group agreed that the forecast pack to be submitted by DNOs in July as part of DPCR5 will be “business as usual” and that the scenario element of the submission will be required two months from the publication of Workstream 3’s findings.

3.6. There was a consensus that it is best to keep the number of scenarios to a minimum with the optimum number being 3. It was discussed that both Ofgem and DNOs should engage with their respective colleagues to inform them of the group’s preferences.

Action	Person – By
Remove Scenarios from C1 in Forecast pack.	MH – 1 May 2012
Ofgem to provide guidance on the scenarios.	JH – Within 1 month of WS3 report
To engage with colleagues to inform them of a preference of three scenarios.	Ofgem and DNOs – ongoing

4. Update to Terms of Reference

4.1. Ofgem reported that the terms of reference has been redrafted and will be further amended following the meeting and circulated to the group.

4.2. The issue of **transparency** was raised – both concerning the CAWG meetings and the decisions taking in setting the cost assessment framework by Ofgem. It was noted that all minutes will be available online and any comments that DNOs do not want attributed, they must state this clearly to Ofgem. Ofgem also noted that it will endeavour to be as open as possible in the cost assessment and will endeavour to provide more commentary around the costs assessment tables in the RIGs (“why we have done what we’ve done”).

Action	Person – By
Ofgem to circulate a redraft of the TOR and submitted comments on the TOR.	SM – 4 May 2012
Ofgem to provide greater levels of commentary in the tables and for decisions made.	C&O team – ongoing

5. CAWG priority areas

5.1. There was general agreement that what was on the slides covered the DNOs priorities, with the DNOs placing emphasis on the CAWG having a role in developing in greater detail the **fast-track process** (ie what is the framework, what Ofgem will/will not do in the fast track sweep, what is Ofgem’s approach to assessing the well justified business plans (WJBP)?)

5.2. Regarding the WJBPs, the DNOs raised the issue of learning from **what constitutes a WJBP** from T1 and GD1 and sought Ofgem’s views on what that would entail. Ofgem welcomed thoughts, comments and feedback from the group on what constitutes a WJBP. This would be discussed throughout the CAWG meetings but any comments on email to ElectricityDistribution.CostsandOutputs@ofgem.gov.uk would be welcome.

5.3. DNOs also raised the issue of how **fast-tracked companies get rewarded**. Are they shackled to their WJBP? It was raised that RIIO-T1 set a precedent for a high IQI reward to FT companies and that they “opt-in” to the “no worse off” principle. It was

agreed that the CAWG has a role in exploring this further. In the meantime, JH of Ofgem agreed to review and feedback on what exactly the “opting-in” will mean.

5.4. Ofgem noted that **past performance** (as per the RIIO Handbook) will influence the decision on fast-tracking. Ofgem also encouraged DNOs to address any areas of poor past performance in the WJBP rather than ignore them.

5.5. The group noted that “**conversion to allowances**” should be a key priority. It was noted that getting the cost drivers right was critical to the entire cost assessment process.

5.6. How to project forward to determine **future performance** was identified as a key priority for the group. There was a concern raised by WPD that in DPCR5 there was a significant flaw in how this was done. In particular where the indirects allowance for DPCR5 which was set on a net basis has the potential not to account for indirects from connections customers.

5.7. A critical issue for RIIO-ED1 is to develop a **common output matrix** where there are clear links between costs and outputs. This can be used to inform cost drivers. This is critical to assessing efficient costs. It relates to the work being conducted in Reliability and Safety Working Group regarding developing a common methodology. Ofgem noted that it has a model to value options which is being used for RIIO-GD1. Ofgem agreed to sent the links to this model and suggested that James Grayburn (Head of RIIO-GD1) to come along to one of the CAWG and give a presentation on this. The group agreed this would be useful.

5.8. The links to this are found here:
<http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=354&refer=Networks/GasDist/RIIO-GD1/ConRes>

5.9. The group discussed the use of **consultants** and it was noted that this brings with it not only risk but also can be burdensome for the DNOs and Ofgem. It was agreed that the use of consultants will be appropriate in certain areas and will only be successful if the TOR are clearly defined (in partnership across the CAWG). The areas of property and IT were identified as areas where external specialist expertise would be useful (noting not to reinvent the wheel from RIIO-T1 and RIIO-GD1). DNOs agreed to give thought and feedback on areas that would merit use of consultants.

Action	Person – By
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 will arrange with James Grayburn to present on the options value model in one of the CAWG meetings	JH – 4 May 2012
DNOs to provide to Ofgem their thoughts on areas that would merit use of external consultants by email ElectricityDistribution.CostsandOutputs@ofgem.gov.uk .	DNOs – 10 May 2012
Ofgem to provide greater clarity on the “opt-in” principle.	JH - 10 May 2012
DNOs to comment and feedback to Ofgem on what constitutes a WJBP.	DNOs – throughout the CAWG process

6. Experience and views from DPCR5

6.1. Ofgem presented thoughts on the experience from DPCR5. There was agreement with these points and in particular, DNOs supported less use of complex regressions and using consultants only when there is a clear case for doing so.

7. Potential workstreams – Business Support Costs

7.1. Martin Rodgers of Ofgem gave a presentation on Business Support Costs (BSCs) and the approach used in T1 and GD1. MR stressed that a variety of techniques will be used to assess BSCs, including externally developed benchmarks.

7.2. The boundary issues between BSCs and CAIs were raised by Bob Parker of WPD. He noted that there were issues with this in DPCR5 and this is a key area of work for the CAWG. Ofgem and other DNOs were in agreement.

7.3. DNOs asked when the work being conducted by Hackett regarding benchmarks would be complete as DNOs sought advance notice of the benchmarks – ie before September consultation. Ofgem hoped that these would be available before then and would keep DNOs informed on this.

7.4. Sarah Walls of ENW raised the point that benchmarks appropriate for transmission operators (TOs) and gas distribution network companies (GDNs) were not always appropriate for DNOs. For example, IT cost per end user is not appropriate for DUoS billing systems, the costs of which bear no resemblance to the number of users. Julian Rudd of UKPN noted that while it is a positive step to use widely accepted benchmarks, it is important that the appropriate costs driver is used.

7.5. JH of Ofgem noted these comments from the DNOs but also raised the point that the RIIO framework does seek commonality (where possible) across the sectors – electricity distribution, gas distribution and transmission.

7.6. It was also reiterated that the DNOs can make the case for a particular costs driver in their WJBPs.

7.7. It was further reiterated by Ofgem that benchmarks is only one technique for assessing costs. A question for future workshops would be what are the other methods/techniques (eg total BSCs, elements of BSCs) etc. MR noted that the decision of what specifically to assess will be developed through the process.

Action	Person – By
DNOs to give thoughts prior to next meeting on further iterations of assessing BSCs (email ElectricityDistribution.CostsandOutputs@ofgem.gov.uk).	DNOs – 10 May 2012

8. Potential workstreams – initial thoughts and interaction with other Working Groups

8.1. DNOs were asked on their thoughts on the potential workstreams (from slide 16 and 17). Ofgem reiterated that any groupings were for meeting purposes only. Ofgem also agreed to pull together a straw-man timetable of what would be covered when and seek comments from DNOs.

8.2. Some initial thoughts emerged which are to be explored in the future meetings. The key issues raised were as follows:

- Disaggregated benchmarking should be considered alongside totex.
- Excluded services needs to be included in the discussions.
- Is gross and net assessment relevant. In DPCR5 gross allowances were set based on net.
- Incremental pension deficits and on-going pension costs – which group will consider these issues?
- Innovation – how will cost assessment account for what is completely new and what is a new way of doing the same thing (eg new assets versus new ways of doing things to maintain same assets).
- Totex – what is the definition? What is included? What is the price base? How will innovation be treated in totex? DNO sharing of their thoughts on this in Meeting 2 was discussed – both ENW and WPD happy to give a presentation. All DNOs were invited to let Ofgem know if they would be willing to present/share thoughts on totex.
- Network Investment will require an update and close working with the Reliability and Safety Working group (RSWG).
- Non-op capex – this may sit better with the discussion on network investment. Julian Rudd of UKPN noted that a debate will be required on how to differentiate between business as usual and large investment projects (eg standard cyclical replacement and smart-related). JH of Ofgem asked if this distinction should be added to the forecast pack – there was some support for this. However, there were concerns regarding the level of uncertainty at this stage. JH therefore suggested just a separate table for visibility purposes only. This was agreed by DNOs.
- Whole project costs are important and there must be a distinction between whole project and whole life costs.
- Network operating costs (NOCs) - it was agreed that the current RIGs on this issue are in fairly good shape. However, there is confusion on what exactly is meant by QoS and non-QoS. It was raised by DNOs that if they carry the risk of storms, there should be an allowance.

JH of Ofgem alerted the DNOs to the current consultation on the Interruption Incentive Scheme (IIS) and non-connections related Guaranteed Standards of Performance (GSOP) found here -

<http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=164&refer=Networks/ElecDist/QualofServ>

- Closely associate indirect (CAIs) - WPD noted that there are 3 key groups – those related to direct costs, those unrelated and shared with group, those unrelated and unique to the DNO. It was agreed that the CAWG needs to investigate group issues. Further it was noted that CAIs in GD1 and T1 were captured under direct opex. There was very strong resistance to such an approach for ED1.
- Organisational design issues – it was noted that totex may begin to alleviate some of the issues with organisation design. However contractor adjustment needs to be resolved. Questions were raised regarding how it is possible for strong performance in certain elements (costs, QoS) to sit alongside poor performance elsewhere (IIS)? This raises the issue of cherry picking where costs go and it is important that Ofgem investigate the specifics. There was a plea from Ofgem at this stage for DNOs to be open to raising any issues that they have discovered.

- Real Price Effects (RPEs) – this group must have a debate on RPE to feed into September paper.

Action	Person – By
Ofgem to provide in the minutes a link to the Dartford Determination consultation document.	SM – 1 May 2012
Ofgem to pull together a straw-man of meeting topics.	JH – 4 May 2012
Ofgem to find out from Bill McKenzie which working group will be dealing with the issue of pension deficits.	SM – 4 May 2012
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
DNOs to provide to Ofgem through email (ElectricityDistribution.CostsandOutputs@ofgem.gov.uk) their thoughts on totex and the sort of things should be considered in developing totex for discussion at the next meeting.	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
Keith Mawson to provide an email proposing some words on RPEs to facilitate consistency in submissions.	KM – 10 May 2012

9. Date of next meeting

9.1. The next meeting will take place on 10 May in London. Venue to be confirmed.

10. Consolidated list of actions

10.1. The table below provides a consolidated list of actions.

Action	Person	Date
Ofgem		
Remove Scenarios from C1 in Forecast pack.	MH	01-May-12
Ofgem to provide in the minutes a link to the Dartford Determination consultation document.	SM	01-May-12
Ofgem to circulate with the minutes comments on costs assessment issues in response to the RIIO-ED1 launch letter.	SM	01-May-12
Ofgem to circulate the links to the options value model being used in RIIO-GD1 with the minutes.	SM	01-May-12
Ofgem to circulate a redraft of the TOR and submitted comments on the TOR.	SM	04-May-12
Ofgem to pull together a straw-man of meeting topics.	JH	04-May-12
Ofgem will arrange with James Grayburn to present on the options value model in one of the CAWG meetings.	JH	04-May-12
Ofgem to add delete the area in the forecast pack regarding	MH	04-May-12

scenarios and add it in separate table for visibility purposes only.		
Ofgem to find out from Bill McKenzie which working group will be dealing with the issue of pension deficits.	SM	04-May-12
Ofgem to provide greater clarity on the "opt-in" principle.	JH	10-May-12
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
DNOs		
DNOs to provide to Ofgem through email their thoughts on totex(ElectricityDistribution.CostsandOutputs@ofgem.gov.uk).	DNOs	04-May-12
DNOs to come back to Ofgem to state willingness to present thoughts on totex at the next meeting.	DNOs	04-May-12
DNOs to give thought prior to next meeting on further iterations of assessing BSCs (email ElectricityDistribution.CostsandOutputs@ofgem.gov.uk).	DNOs	10-May-12
DNOs to provide to Ofgem their thoughts on areas that would merit use of external consultants by email ElectricityDistribution.CostsandOutputs@ofgem.gov.uk .	DNOs	10-May-12
Keith Mawson to provide an email proposing some words re RPEs to facilitate consistency in submissions.	KM	10-May-12
DNOs to comment and feedback to Ofgem on what constitutes a WJBP.	DNOs	ongoing
To engage with colleagues to inform them of a preference of three scenarios.	Ofgem and DNOs	ongoing