

The background features a large, stylized white arrow pointing to the right, set against a blurred image of a modern building with a glass facade and a large, glowing, multi-tiered structure resembling a gas burner or a decorative light fixture. The overall color palette is dominated by blues, oranges, and whites.

Cost Assessment Working Group (CAWG)

Meeting 2
10 May 2012

Today's Agenda

Morning Session

- Update on actions from last meeting
- Meeting planner
- Totex
 - Presentations from UKPN, SSE, WPD and ENW

Afternoon Session

- Network Investment

Update on Actions - Ofgem

Action	Who	By	Complete
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 scenarios and add it in separate table for visibility purposes only	MH	04-May-12	✓
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	

Update on Actions - DNOs

Action	Who	By	Complete
DNOs to provide to Ofgem through email (ElectricityDistribution.CostsandOutputs@ofgem.gov.uk) their thoughts on totex	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 to facilitate consistency in submissions.	KM	10-May-12	✓
DNOs to comment and feedback to Ofgem on what constitutes a WJBP	DNOs	ongoing	FCWG?
To engage with colleagues to inform them of a preference of three scenarios	Ofgem and DNOs	ongoing	

Meeting Plan – thoughts?

Other/ related issue	Main Agenda Item					
	26-Apr-12	10-May-12	29-May-12	26-Jun-12	10-Jul-12	31-Jul-12
	Overview	Totex & Network Investment	NOCs, CAIs & Non-Op Capex	Totex & Network Investment	NOCs, CAIs & Non-Op Capex	TBC - dependent on progress
Business Support costs	✓				✓	
Core & non-core		✓		✓		
Cost drivers		✓	✓	✓	✓	
Data sources and expert/consultant review				✓	✓	
Fixed costs		✓	✓	✓	✓	
Future costs/activities				✓	✓	
Guaranteed Standards					✓	
IIS/QoS				✓		
Innovation		✓				
IQI				✓		
Organisational Design		✓	✓			
Pension costs				✓		
Regional factors		✓	✓		✓	
RPEs		✓		✓	✓	
Uncertainty mechanisms				✓		
Whole life costs		✓				
Workforce Renewal			✓		✓	

The “opt-out” Principle

- First proposal should be best effort
- Benefits of fast-tracking (financial, reputational)
- Ofgem choice of who is fast-tracked
- Ofgem set IQI on first submission

Totex – DNO Presentations

- UKPN
- SSE
- ENWL and WPD

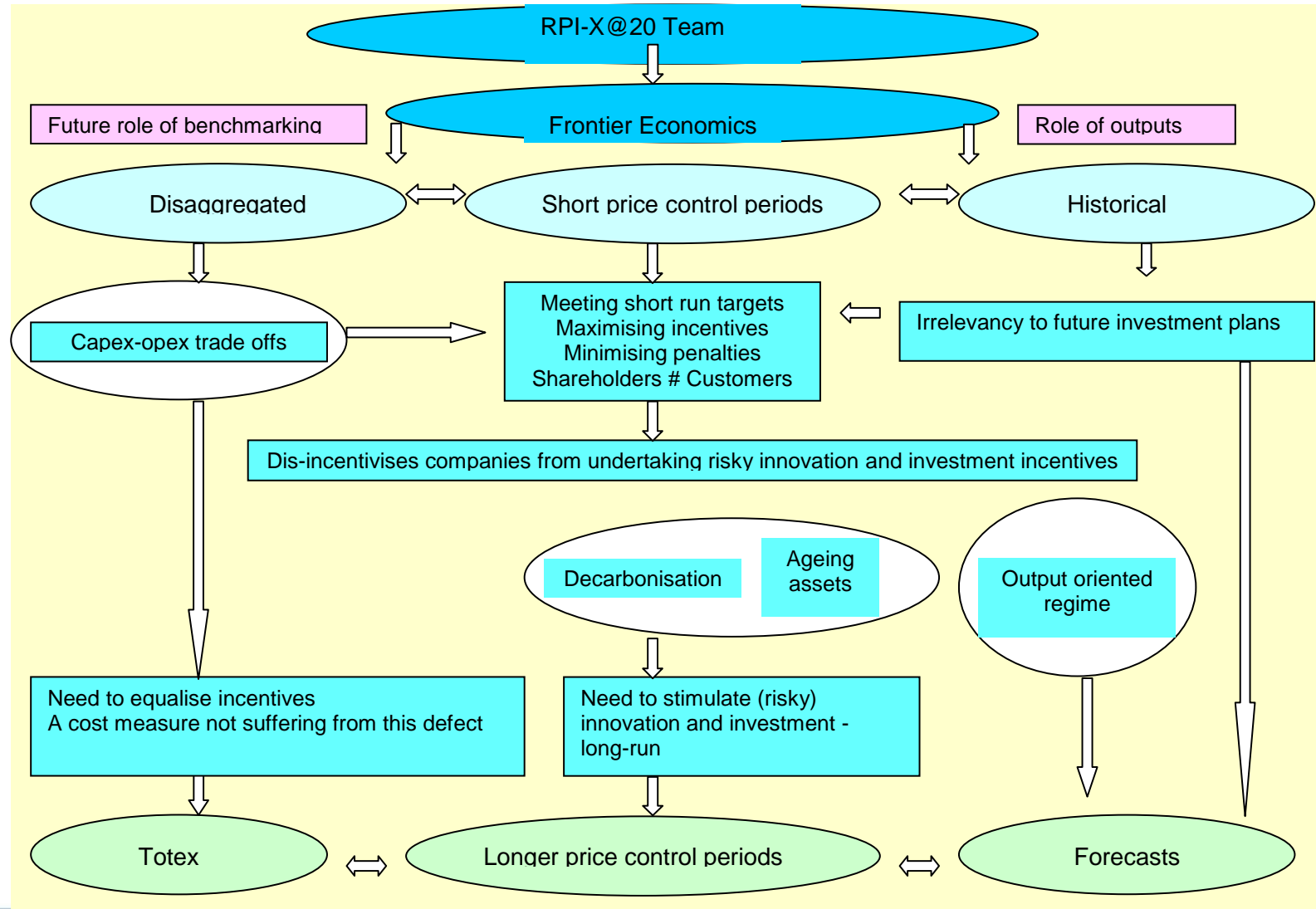
Totex – Ofgem Perspective (1)

- Total expenditure (totex) is defined as operational expenditure (opex) plus actual capital expenditure (capex), ie:
$$\text{Totex} = \text{opex} + \text{capex}$$
- This cost aggregation method was chosen for its simplicity and comparability
- Totex is to be used as part of a toolkit approach supported by a well justified business plan

Totex – Ofgem Perspective (2)

- Drivers are identified on the basis of engineering expertise
 - critical that our datasets are drawn from companies that are comparable so that there are no idiosyncratic reasons for variations in efficiency
 - comparable data for benchmarking
- The totex approach
 - aggregated analysis – fast tracking
 - disaggregated analysis – more detailed scrutiny

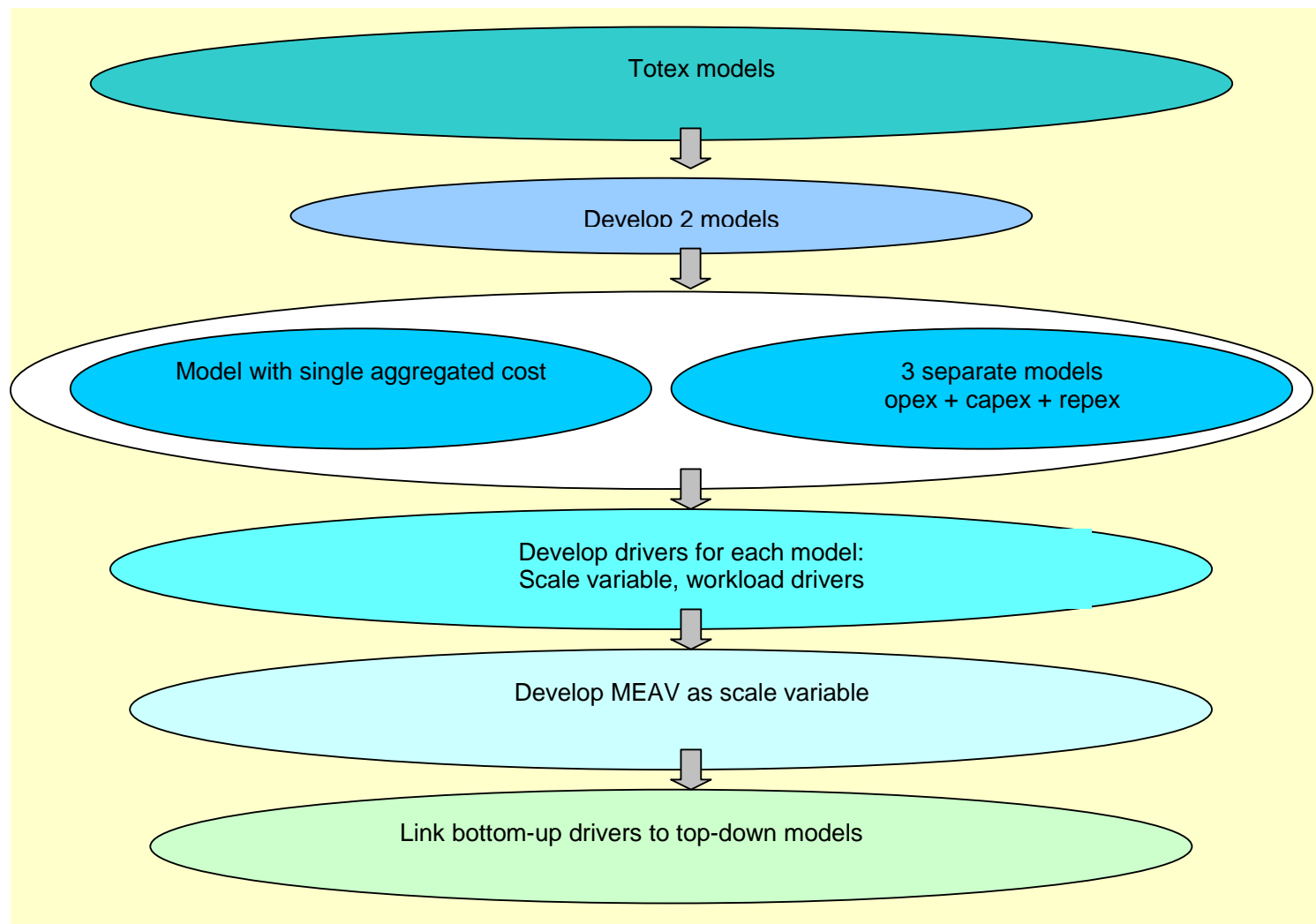
Background



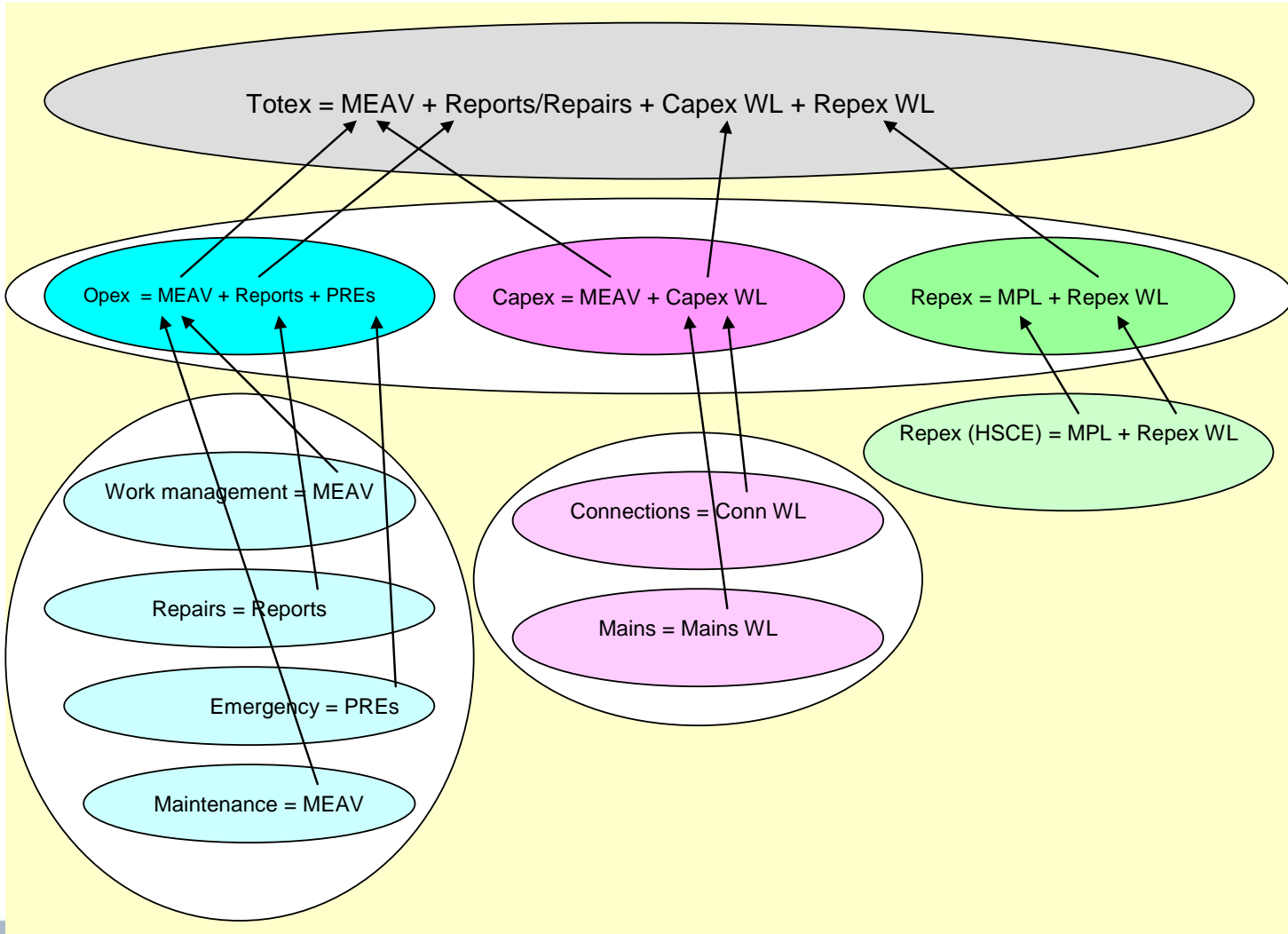
RIO-GDI theoretical recommendations

Recommendation factor	Total costs approach	Disaggregated costs approach	
Purpose of approach	<ul style="list-style-type: none"> To support the 'initial sweep' of companies' forecast business plans 	<ul style="list-style-type: none"> To support the 'initial sweep' of companies' forecast business plans 	<ul style="list-style-type: none"> To support detailed analysis of companies which do not pass the 'initial sweep'
Costs	<ul style="list-style-type: none"> Total expenditure (Totex) 	<ul style="list-style-type: none"> Total operating expenditure (opex) Capital expenditure (capex) Replacement expenditure (repex) – if data allows Business support costs (BSCs) Network operating costs (NOCs) 	<ul style="list-style-type: none"> More disaggregated cost activities
Cost drivers	<ul style="list-style-type: none"> Scale, operating environment and outputs variables, guided by engineering knowledge, empirical analysis and data availability 	<ul style="list-style-type: none"> Scale, operating environment and outputs variables, guided by engineering knowledge, empirical analysis and data availability 	<ul style="list-style-type: none"> Scale, operating environment and outputs variables, guided by engineering knowledge, empirical analysis and data availability
Sample	<ul style="list-style-type: none"> Use data for the 8 GDNs Use panel data where possible, otherwise single year cross-section data Use forecast costs and historical costs 	<ul style="list-style-type: none"> Use data for the 8 GDNs Use panel data where possible, otherwise single year cross-section data Use historical costs 	<ul style="list-style-type: none"> Use data for the 8 GDNs Use panel data where possible, otherwise single year cross-section data Use historical costs
Technique	<ul style="list-style-type: none"> COLS cross-checked with DEA 	<ul style="list-style-type: none"> COLS cross-checked with DEA 	<ul style="list-style-type: none"> COLS cross-checked with DEA

Totex models RII0-GD1



The totex approach RIIIO-GD1





Promoting choice and value
for all gas and electricity customers

A collage background featuring a large white arrow pointing right, a field of solar panels under a bright sun, a stack of white ceramic bowls, and a close-up of wheat stalks.

Lunch

Network Investment DPCR5 (1)

- Network Investment was split into core and non-core expenditure. Non-core expenditure was then split by *ex-ante* allowance or those subject to logging up and re-opener mechanisms
- The methodology used was named the “analytical model”. This encompassed the use of a number of different techniques to assess the Network Investment building blocks
- The building blocks were dependent on the driver for investment and the data available
- Where unable to use analytical models qualitative reviews took place supported by technical advisors

Network Investment DPCR5 (2)

- Some of the techniques used:
 - An aged based asset replacement model (survivor model) based on asset age profiles and the probability of assets failing for different ages
 - Unit cost benchmarking
 - Benchmarking the cost of adding capacity
 - Benchmarking capacity added to demand growth
 - Run-rate and trend analysis
 - Reconciliation of forecast volumes and output data using the load indices and health indices

The background of the slide is a composite image. On the left, there are rows of solar panels under a bright sun. On the right, a hand is shown holding a white document. In the bottom left corner, a blue gas burner is visible. The overall theme is energy and customer service.

ofgem

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