Ofgem's Price Control Review Forum

Summary of proceedings

Venue: Queen Elizabeth II Conference Centre
Broad Sanctuary, London, SW1P 3EE
Date: 29 May 2012, 13:00 – 17:00

On 29 May 2012, Ofgem held the fifth Price Control Review Forum (PCRF) for the electricity and gas transmission price control (RIIO-T1) and the gas distribution price control (RIIO-GD1). This was also the first PCRF to cover issues for the next electricity distribution price control (RIIO-ED1). We summarise the main points arising in the meeting below. Annex 1 sets out the membership at this PCRF.

Introduction and purpose of the meeting

Ofgem highlighted the main purposes of the meetings as being:

- to provide a progress update for each review
- for NGET, NGG and the GDNs to provide an overview of their updated plans for discussion
- to discuss key policy issues for each of the reviews.

Ofgem noted that there would be separate sessions for each of the RIIO-T1, GD1 and ED1 controls and that attendees for each meeting would vary.

RIIO-T1 Session

Overview of the progress so far

Ofgem provided an updated on the timetable to date. It was noted that the business plans of SP Transmission Ltd (SPTL) and Scottish Hydro Electric Transmission Ltd (SHETL) had been fast-tracked and Final Proposals published for each of those companies.

In relation to next steps, Ofgem highlighted that the timescales were similar to a previous price control process with Initial Proposals due to be published in July and Final Proposals to be published in December.

Ofgem noted its intention to hold a final PCRF meeting for RIIO-T1 and GD1 in October 2012.

Overview of business plans and policy questions

National Grid provided an overview of the key issues from its electricity and gas transmission business plans.

Visual amenity

A representative of the Campaign for National Parks sought an update on NGET's progress on its willingness to pay for undergrounding of existing wires.

National Grid noted that the work had recently been completed and that they were currently digesting the results. However, initial analysis suggested almost a 50/50 split between parties willing to pay more and those not willing to pay more. Among those that did not favour paying more National Grid noted a clear message that households are feeling squeezed.

One attendee asked whether, given support was so finely balanced, they had considered dropping proposals in this area. National Grid noted that they had not decided how to progress this at this stage. However, they noted the intention to discuss the issue further with stakeholders.

Another attendee asked whether the results had been analysed by customer segment e.g. between urban and rural. National Grid noted they had not yet had the opportunity to undertake this work.

Electricity transmission uncertainty mechanisms

National Grid provided a summary of the proposed uncertainty mechanisms in its business plan.

One attendee questioned whether copper price risk was just a part of normal business risk and therefore whether any specific mechanism was appropriate. National Grid noted that they had significant potential exposure for changes in metal prices but that they would bear a significant portion of the risk as the mechanism would only be triggered if it was outside a deadband and indeed after a time lag.

Another attendee asked for clarity as to how the mechanism would apply in the context of undergrounding. National Grid confirmed that the mechanisms would apply in the same way.

A third attendee questioned whether there needed to be an uncertainty mechanism associated with Scottish Independence and specifically its implications for network investment. National Grid set out the view that there was not a need for a specific mechanism as it was already reflected in existing mechanisms around future network investment.

Electricity transmission – financial issues

One attendee queried why National Grid was proposing a 7.5% cost of equity for NGET when SPTL and SHETL had only received a 7.0% cost of equity. National Grid noted that they had a different risk profile with a greater proportion of its expenditure being fixed upfront.

The same attendee noted that the Scottish TOs proposed capital investment was greater relative to Regulatory Asset Base (RAB). National Grid note that NGET's increase was actually comparable to SPTL and that, in the case of SHETL, its financial arrangement would mean it would receive more in fast-money ie it would receive its cash-flow quicker.

One attendee noted that NGET would be getting 8 years of certainty rather than 5 years under a previous price control and, given its rate of return was set for 8 years, that a RIIO price control reduced their risk. National Grid noted that it depended on when a company was spending its money and that there was scope for significant change, including policy changes, over 8 years. They further noted that the risk argument could be seen both ways ie in some ways it reduced revenue risk but it also increase cost risk.

Another attendee argued that, reflecting changes in the industry, there would actually have been a greater risk to NGET if the RIIO arrangements had not brought about the proposed changes.

Gas uncertainty mechanisms

National Grid provided a summary of its proposed gas uncertainty mechanisms. They provided more detail on the proposed changes to the incremental capacity arrangements. They also noted the intention to host a workshop at the end of June to discuss the proposals with industry stakeholders in further detail.

One attendee asked why the proposed changes to the incremental capacity arrangements had only been tabled so late in the day and questioned whether, given it was unlikely the changes could be introduced for 1 April 2013, transition arrangements were needed. National Grid noted that the proposals had been discussed with industry at various stages during the process and had developed over this time with their input.

An Ofgem representative noted that the key issues was about when stakeholders had been made away of the detail of the proposals and that 1 May 2012 was really the first time industry had been presented with this detail. National Grid noted that the timetable the development of the arrangements had followed was necessary given separate developments in relation to timely connection arrangements and that it could not have realistically progressed any further.

One attendee noted that the Gas Storage Operators Group and CSL supported the moves made by NGG towards improving the arrangements for the provision of capacity. However, they also noted that the proposals were complex and that they should have been more involved in development before these detailed proposals were put on the table. The attendee welcomed more co-ordination of the process going forward.

One attendee asked about the network flex arrangements and questioned what uncertainty was taken into account reflecting demand-side measures in electricity.

One respondent questioned whether any uncertainty provisions had been made for the development of shale gas. National Grid noted that this would be captured as part of the incremental capacity proposals.

One attendee asked for further clarity on NGG's proposed uncertainty mechanism for asset health. National Grid noted that this was concerned with the design risk as assets get increasingly older. They noted it would only apply for high impact event where asset health spend would be 10% greater than the baseline plan as a result of a single source.

In relation to risk associated with material prices, one attendee questioned whether National Grid had considered commercial mechanisms such as hedging. National Grid confirmed that they had considered such mechanisms but that they exorbitantly expensive. Another attendee noted that there may be technological improvements that actually reduce prices. National Grid noted that it had considered hedging but that such approaches were not cost effective. They also noted that other such improvements would require to be trialled.

<u>Gas – financial proposals</u>

One attendee questioned why the financial packages were essentially the same for NGET and NGG. National Grid noted that there were the same in some respects but that they had different asset lives and the proposed capitalisation rate was very different.

One attendee noted that NGET had signalled a potentially significant increase in prices – potentially a 25% increase in TNUoS charges - from April 2013. They questioned how the impact on customers should be mitigated. National Grid noted that this reflected a number of factors not just RIIO-T1. An Ofgem representative noted that one area it is looking at is in relation to volatility and that Ofgem intends to publish its proposals in this area shortly.

RIIO-GD1 Session

GDN presentations of business plans

Each GDN presented the key aspects of their second business plans; the presentations were then followed by a discussion by PCRF members. The GDNs' presentations are available on our website.

Social outputs – carbon monoxide

A representative from a carbon monoxide (CO) charity queried why WWU were seeking to improve back office procedures in order to address CO-related risks. WWU clarified that this was in order to improve staff awareness of the dangers of CO poisoning, both for their own benefit and to assist customers.

NGN were asked what additional costs they were incurring for introducing new gascoseekers (with additional CO detection) functionality. NGN confirmed that they were not proposing to include any additional cost items in their plans, but would instead absorb any associated cost within their overall operating cost allowances. The representative from the CO charity commended NGN on their approach.

A major energy user representative stated that they believed the GDNs' responsibilities ended at the meter and they should not assume any responsibility for managing CO-related risks. SGN recognised that suppliers and customers also had responsibilities in this area and that their proposals reflected undertakings that they, and their stakeholders, felt were appropriate for a GDN.

A HSE representative questioned how consistent the GDNs were in their approach to tackling CO-related risks. Ofgem highlighted that whilst each GDN had set out a range of different activities they proposed to undertake, they all broadly sought to raise awareness. Ofgem would be working with the GDNs to develop a common measure of awareness to assess the impact of different approaches.

Social outputs – fuel poor network extensions:

A consumer representative asked how well GDNs understood the incidence of fuel poverty within their licensed area, and how this had informed their plans. A major energy user noted that network charges should not be used to subsidise new connections.

A consumer representative questioned how NGN had derived the projected numbers of fuel poor consumers they planned to connect to the gas network. NGN had commissioned a study that looked at the overlap between their networks and incidents of fuel poverty. They then looked to share data with other providers of energy solutions, social landlords and other agencies involved in addressing fuel poverty.

A major energy user representative challenged the role network operators should play in addressing fuel poverty given the principal relationship with the customer was via their supplier. WWU highlighted that as the GDN was the provider of last resort for a connection to the network they did have a relationship with customers. All GDNs confirmed that they worked closely with suppliers in delivering solutions to the fuel poor.

A consumer representative observed that the plans did not show how initiatives undertaken in the current price control – and rewarded under the Discretionary Reward Scheme – had been built into the baselines for RIIO-GD1.

Uncertainty:

A DECC representative asked how GDNs had addressed uncertainty over future network use in their business plans, e.g. prioritising opex solutions relative to capital solutions.

WWU stated that in shifting expenditure from capex to opex they were taking appropriate measures to minimise potentially uneconomic investments. NGGD described how their asset management framework considers current asset health, scenarios and options for improving asset health; where there is uncertainty they will look to extend asset lives rather than replace. NGN added that none of the GDNs had forecast demand growth into their plans. SGN added that there was considerable incentive to innovate and trial alternative ways of utilising gas in association with other energies.

Other issues

Interruptible contracts: A major energy user representative questioned how NGN would be able to achieve a greater number of customers opting for interruptible contracts. NGN replied that whilst their projections may be optimistic given current low levels of take up, they were prepared to take this risk in their business plan

Shrinkage: A developer considered that there was insufficient information on shrinkage in business plans. GDNs agreed to provide more data to the developer.

Depreciation rates: A question was also raised on the impact of changes to depreciation rates. NGN stated that transitional arrangements were required at the beginning of the period to ensure the revenues available were sufficient to maintain financeability.

Benefits of RIIO framework: A major energy user representative commented that RIIO did not appear to be delivering any benefits to consumers – each of the business plans reflected higher costs (and prices) than currently experienced. The respondent considered that the sale of distribution networks should have led to better benchmarking and lower costs. Ofgem responded by emphasising our intention to use benchmarking information to set allowances and that the impact of this will be evident in our Initial Proposals document.

RIIO-ED1 Session

The session began with a presentation from Renewable UK. This was followed by a presentation from Ofgem on key issues being considered at working groups (slides attached).

Renewable UK believe we need to clear understanding of what playing 'a full role in the delivery of a low carbon future' means. Ofgem replied that this discussion is scheduled to take place at the next Flexibility and Capacity Working Group. They also considered that goals for RIIO-ED1 need to be established – and wondered whether RIIO-ED1 would be deemed to be successful if the UK successfully decarbonised the electricity system by 2030.A major energy user representative challenged any presumption that DNOs are responsible for the decarbonisation of the energy system. A developer added that the goals should be to enable an energy system that, in order of priority, is 'affordable, secure and clean'. Ofgem stated that the open letter launching RIIO-ED1 had set the objective of RIIO-ED1 as ensuring DNOs are not barriers to achieving the Government targets. A DNO representative commented that decarbonisation was not necessarily the responsibility of DNOs, but it was an issue that they could discuss with their stakeholders. A DNO representative emphasised the need for the price review to have flexibility built into it in order to reflect a range of uncertainty.

In discussing outputs related to network connections, a developer emphasised the need for separate approaches for different customer groups; for high value projects the asymmetry of information is more important than the speed of connection. A DNO reflected that for certain customers in London the risk that the connection would not go ahead as planned was the most critical aspect of the service provided by the DNO.

A supplier questioned why Ofgem had not established a separate working group to review supplier issues, in particular the impact on prices of moving to a new price control period. Ofgem highlighted their current consultation on price volatility and would be considering how to manage this issue in relation to RIIO-ED1. The supplier wanted the timescale for RIIO-ED1 to be brought forward to enable suppliers early sight of 2015 prices. Ofgem responded that the timetable would not change but that the submission of the DNO business plans and the fast tracking process should provide suppliers with early sight of potential step changes in allowed revenues. Ofgem took an action to further consider the transition in prices from DPCR5 and RIIO-ED1; recognising the consensus that the impact on prices was not well communicated for DPCR5. The DNOs agreed that, as part of their stakeholder engagement, they would liaise with suppliers to discuss the potential impact on prices arising from their emerging business plans.

Annex 1: List of attendees

Name	Organisation	Representing
Aileen McLeod	SSE	GDN (gas distribution networks)
Alison Sleightholm	WPD	DNO
Andy Manning	Centrica	Supplier
Antonio Ciavollella	BP Gas	Gas Storage
Antony Miller	Centrica	Supplier
Ben Wilson*	UKPN	DNO
Colin Connor	HSE	Government
Colm Gibson	FTI Consulting	Consultant
Eddie Profitt	Major Energy Users Council	Medium and Large Users of Energy
Hannah Lewis	DECC	Central Government
Helen Campbell	National Grid	GDN
Helen Inwood	Npower	Supplier
John Cristie*	DECC	Central Government
Keith Hutton*	UKPN	DNO
Keith Noble-Nesbitt	NPG	
Neil Griffiths-Lambeth	Moodys	The City
Paul Bircham*	ENW	DNO
Paul Hawker	DECC	Central Government
Paul Overton	CO- Gas Safety	
Paul Whittaker	National Grid	TO
Pauline McCracken	National Grid	TO
Richard Allman	National Grid	TO
Ruth Bradshaw	Campaign for National Parks	Local and National Environmental Groups
Ruth Chambers	Campaign for National Parks	Local and National Environmental Groups
Sarah Walls*	ENW	DNO
Sharon Darcy	RIIO-T1 consumer challenge group	Specialists in consumer issues
Sheila Wren	John Muir Trust	Local and National Environmental Groups
Simon Holden	Holder and Hacking	
Stephanie Trotter	CO – Gas Safety	
Stephen Parker	Northern Gas Networks	GDN
Steve Edwards	WWU	GDN
Zoltan Zavody	RenewableUK	Renewable energy Producers

* Only attended the RIIO-ED1 session