Minutes

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RIIO-GD2 Cost Assessment Working Group – Meeting 2		
From: Ofgem	Date: 05th September 2018 Time: 13:00 – 18:00	Location: Ofgem, Glasgow

1. Present

Ofgem representatives;

Geoffrey Randall
Martin Siner
Tessa Hall
Callum Mayfield
Jonathan Farrier
Daniel Kyei
Teresa Romano
Nicole Weir

Stakeholder representatives;

Cadent
NGN
SGN
WWU

2. Introductions

2.1. Ofgem introduced the process for RIIO-GD2 stakeholder groups, and gave a brief summary of the key timings for RIIO2 as a whole. Then Ofgem outlined the purpose and expectations of this working group meeting.

3. Terms of reference

3.1. Ofgem asked stakeholders if they are happy with the working group terms of reference (sent to stakeholders before the meeting for their review). Stakeholders agreed that they are happy with the terms of reference and there were no suggested additions or alterations.

4. Review of cost drivers and cost categories (NGN)

4.1. There was discussion on the loss of metering work, both in relation to metering contracts coming to an end, and due to smart meter rollout. With regard to the end of metering contracts, one stakeholder stated that they are expecting a loss of metering work when existing contracts come to an end in 2021. Stakeholders discussed the impact of this loss of metering work, and whether this issue will persist into RIIO-GD2. It was said that the impact can be mitigated to an extent by flexing the workforce, but despite this, the impact may still be felt for years.

4.2. Stakeholders identified that there is uncertainty over the expected future workload of metering work as more smart meters are rolled out. They are already seeing a decrease in metering work, and are anticipating that this will decrease further in the future, but the extent of the change is uncertain. One stakeholder highlighted how this uncertainty means that historical benchmarking may not be a good predictor of the future in this area due to the changing environment (in relation to smart meters).

4.3. There was discussion on the use of external condition reports as a cost driver in RIIO-GD1 in the repairs cost category. The point was raised by a stakeholder that repairs drive costs, not the number of reports. However, there is inconsistency in the way that GDNs report repairs. For example, some GDNs may just report one repair, even if multiple joints are fixed, whereas others may officially report each individual joint repair in this same situation. There was a consensus that external condition reports are recorded more consistently than repairs.

4.4. One stakeholder suggested that more proactive GDNs will spend more per condition report as they will go and fix multiple repairs. They also stated that it could be interesting to revisit the relationship between number of reports and repairs, and see if the difference between the two is driving a cost difference.

4.5. Stakeholders also highlighted that there are differences in accounting for routine and non-routine maintenance between GDNs, and several examples of this were discussed. Ofgem added that this shouldn't impact them if all of the costs are moved to opex in the regulatory reporting pack (RRP). Stakeholders agreed with Ofgem's statement, but one stakeholder suggested that non-routine maintenance could be moved to capex rather than opex in RIIO-GD2, and another stakeholder suggested that Ofgem could change the way that maintence in reported in the RRPs to be aligned with how GDNs tend to report these costs internally.

4.6. There was a brief discussion on Maintenance MEAV, and several concerns were raised over its use. One stakeholder thought that an approach of basing the weight of individual categories of MEAV on industry spend in previous years was logical. However, two stakeholders stated that the condition of assets varies between networks, which causes an issue with this approach, and makes it difficult to benchmark this area.

4.7. There was discussion over the opex-capex tradeoff in terms of the allocation of costs associated with maintenance. One stakeholder suggested that the totex regression is better suited to maintenance as it gets rid of the choices between capex and opex, and the higher level of aggregation increases confidence.

4.8. In relation to the business support cost category, there were queries raised by some stakeholders of whether economies of scale were taken into account in RIIO-GD1. One stakeholder suggested that there were also issues in this area with cherry picking as under the bottom-up approach the Upper Quartile was determined separately for regressed costs and Business Support, whereas the totex view overcame this problem.

4.9. For RIIO-GD2, in terms of IT, the GDNs will be at different stages with their IT improvements and changes. There was a general consensus with Ofgem and stakeholders that IT should be looked at separately to other business supports costs. One stakeholder raised an idea that IT could be separated into business as usual and bespoke IT. A number of stakeholders agreed that IT opex and IT capex were best considered together, as the advent of cloud computing made the distinction out of date.

4.10. One stakeholder suggested that cost driver synthetic costs need updating for RIIO-GD2 as the larger diameter bands of repex work has become proportionally more expensive compared to smaller diameter bands since the synthetic costs were calculated for RIIO-GD1. There was also a discussion of secondary drivers, such as working in the road as compared to the pavement or verge, and the use of open-cut as opposed to insertion techniques. In addition, a number of stakeholders suggested that carbon reduction was the main benefit of the mains replacement programme.

4.11. Stakeholders made several suggestions to Ofgem in relation to the capex cost category for RIIO-GD2. For example, one stakeholder suggested that synthetic unit costs for

connections and mains reinforcement will need updating. It was also suggested that fuel poor connections could be included with their own synthetic unit costs in the regression for connections rather than treated separately. A stakeholder raised an issue relating to the assumed recovery rates applied to fuel poor connections in RIIO-GD1, and stated that they should be looked at again for RIIO-GD2, as the recovery is much lower in reality. Stakeholders also discussed the 'other capex' category, and questions were raised over the reliability of reporting in this area.

4.12. Ofgem asked for any other comments or views on this presentation topic. It was suggested by one stakeholder that Ofgem need to think about what makes a good cost driver, and what Ofgem are trying to achieve. They stated that before we start suggesting possible alternative drivers, there is a need for a definition and criteria for what a cost driver should be.

4.13. One stakeholder raised concerns that cost drivers just drive low cost, and not quality, which isn't the best outcome for consumers. They stated that this issue around driving quality is something they are looking into, and this could potentially be something that they could bring to a future working group.

5. High level discussion points for Network Output Measures (NOMs)/monetised risk/network asset health (SGN)

5.1. There was a discussion on NOMs and their potential role in RIIO-GD2. It was stated by one stakeholder that NOMS had not been developed with cost comparison in mind and as such there may be data consistency issues within the models. It was pointed out by a stakeholder that NOMs targets haven't been signed off or used yet, so it's too early to know how it will work. Overall, there was a consensus from stakeholders that the role of NOMs in setting allowances RIIO-GD2 should be as a decision support tool, but

nothing more. Stakeholders suggested that it could be used as a useful reporting tool to help inform the business plans and investment planning.

6. RPE indexation (Cadent)

6.1. The group discussed what makes a good index. One stakeholder stated that any index must be reflective of efficient GDN costs. It was agreed by stakeholders that the most prominent and challenging RPE element is contract labour, particularly for mains replacement. There was a consensus across all stakeholders that they aren't currently aware of a suitable index for contract labour, and they need to look into this further.

6.2. In considering the potential absence of a robust index, one stakeholder stated that an advantage of a forecast over a poor index is that a forecast at least provides price visibility and stability.

6.3. It was suggested in the presentation that it is possible to apply indices to a common notional structure or individual GDN structures, but that the common notional structure is the better approach to avoid issues with reporting inconsistencies between GDNs. These two approaches were discussed, and in the end, there was a general consensus that applying indices to a notional structure is sensible.