

Outputs & Incentives - Repex Policy Development

Working strawman slides for working group



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- Objectives of RIIO-GD2 and the repex programme
- Repex in the context of GD2 outputs
- Purpose of the upcoming discussion
- A clarification around terminology
- Strawman of positions for discussion
 - Strawman positions on specific outputs
 - Options for structuring repex outputs in GD2
 - Advantages and disadvantages of different options
- Repex interactions with RIIO incentive mechanisms

The ideas and views presented today are part of ongoing policy development for RIIO-2.

These slides are intended to help share some of our thinking at the current time, but do not constitute a final view on any of the issues being discussed.

We will continue to develop the issues being discussed today and, therefore, some views may be liable to change.

Repex has a number of interactions and interlinkages with the wider price control framework, which itself remains under development. Therefore, changes in other areas may result in the need to revise some of the issues being discussed today.

Framework Decision – headline objectives:

- Our objective for RIIO-2 is to ensure that regulated network companies deliver the value for money services that both existing and future consumers want. In particular, that the price controls:
 - Give due attention to mitigating the impact of networks on the environment
 - Are designed so that networks play a full role in addressing consumer vulnerability issues.
- To do so, they should develop and maintain a reliable, safe and secure network that is flexible in supporting the transition to a low-carbon future.

Working objectives of the GD2 repex package:

- Remove and manage current and future risk from the gas distribution network
- Deliver ongoing improvements in operating efficiency and reductions in greenhouse gas emissions
- Encourage asset management strategies that maximise the benefits to current and future consumers
- Allow scope for networks to deliver cost efficient projects, while ensuring a balanced workload mix is delivered over the price control period
- Protect consumers by clearly tying cost allowances to workloads delivered
- Incentivise network companies to undertake innovation and drive cost efficiencies through the business

Direct

- Outputs that are specific to the 'repex' part of the price control
- Primarily in place to ensure alignment between workloads and cost allowances
- Provide incentive to deliver cost efficient projects and mix of workloads across the price control period

Interlinked

- Output targets in other areas of the price control framework which are impacted by the undertaking of repex work
- Achieving these targets is at least in part, if not strongly, influenced by completing repex workloads

Example outputs

Direct

Volume-based
outputs for repex

MRPS risk removed
target

Interlinked

NARMs

Shrinkage &
emissions

Planned
interruptions

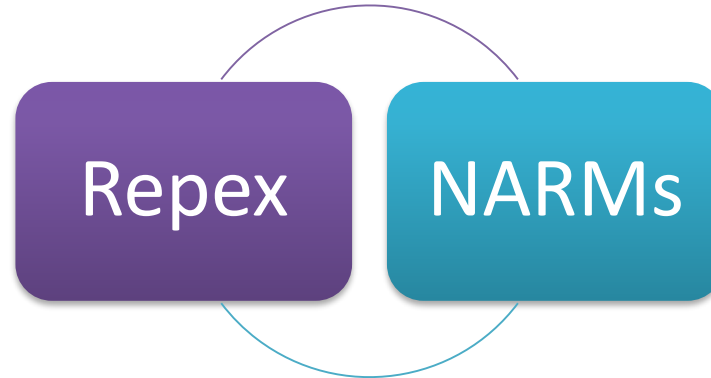
Customer
satisfaction

Complaints

Customer service

Stakeholder
engagement reward

GSOPs



- There are 6 NARMs asset categories...
 - ...of which *mains*, *services* and *risers* are covered by the repex programme
 - *Mains* is further split into 4 sub-categories – *iron*, *PE*, *steel*, *other*
- Replacement activity carried out under repex programme (whether mandatory or non-mandatory) contributes to reduction in £R under NARMs
- Mains accounts for 41% of overall industry £R risk score
 - Service = 16%; risers = 4%

Business Plan formulation

Repex: Develop justifications for workload forecasts for GD2

NARMs: Proposed approach to managing risk in GD2 and beyond

Final Proposals

Repex: workload forecasts finalised

NARMs: £R risk reduction target finalised

GD2 implementation

Implement asset management strategy

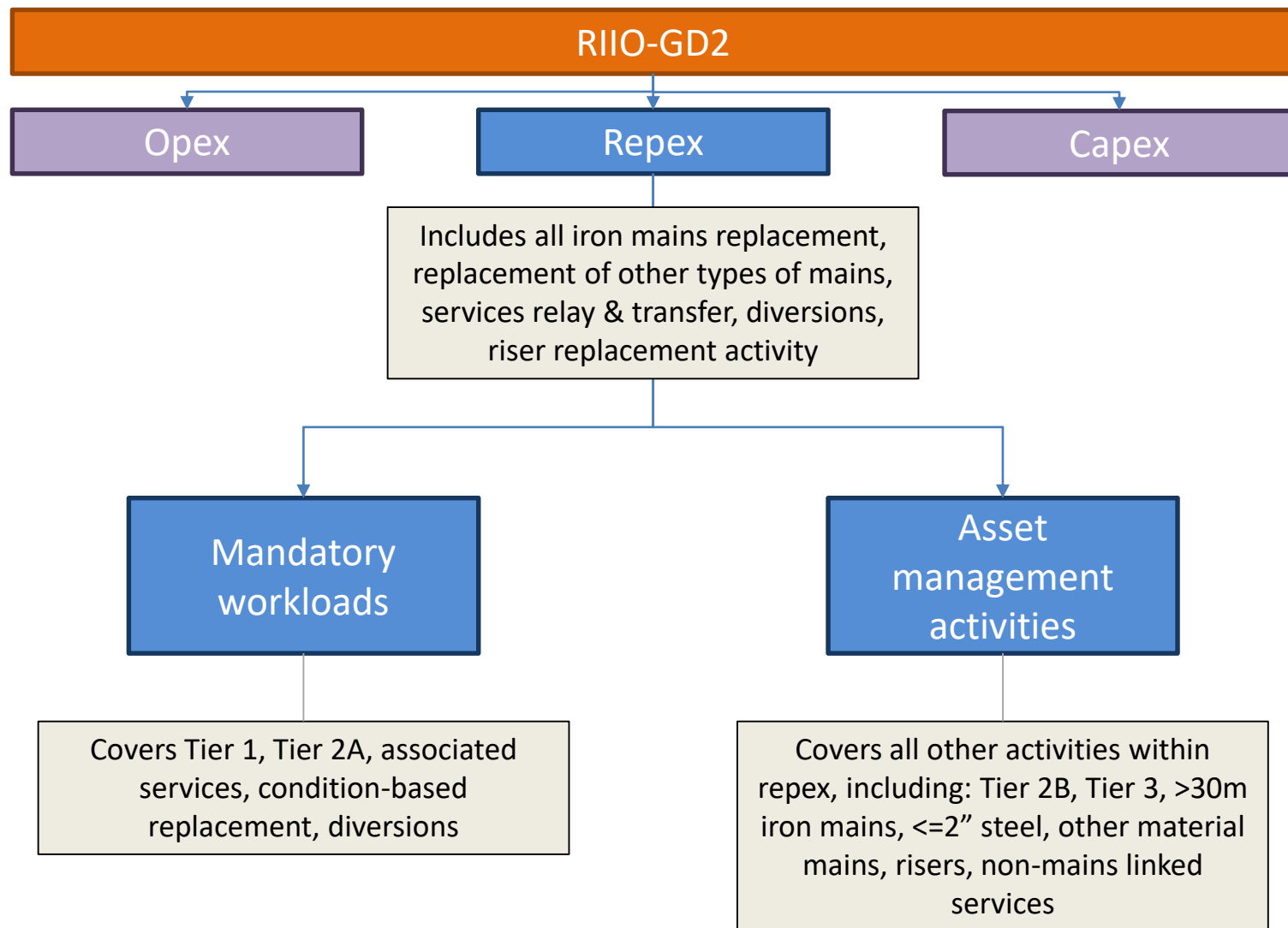
Variations from workload forecasts in BP require justification – NARMs is one way of providing this

What we are trying to achieve today:

- To present and discuss possible options for the DIRECT outputs that may form repex policy in GD2
- To understand the potential advantages and disadvantages of the different options and consider where changes could be made
- To understand the possible linkages between the DIRECT outputs presented in each of the options and the INTERLINKED outputs within the price control and identify any areas where there is potential for conflicting incentives

What we're not trying to do today:

- Identify the specific levels at which any outputs should be set
- Reach consensus on a preferred option for DIRECT outputs
- Discuss the structure or options of any INTERLINKED outputs (this is happening in other forums)



Strawman for discussion

Possible repex output targets under different options

Output	1. Ensuring workload delivery	2. Semi-flexible asset management	3. Flexible asset management	
Length of main off-risk: <i>Tier 1 volumes</i>	Km abandoned (in line with HSE targets)	Km abandoned (in line with HSE targets)	Km abandoned (in line with HSE targets)	Mandatory repex
Length of main off-risk: <i>Tier 2A & non-standard materials volumes</i>	No output target – indicative forecast w/ volume driver	No output target – indicative forecast w/ volume driver	No output target – indicative forecast w/ volume driver	
Length of main off-risk: <i>Tier 2B/ Tier 3/steel mains/>30m iron/elect <2" steel mains volumes</i>	Km abandoned for each category	Km abandoned for each category +/-X%	No output target – indicative forecast w/ volume driver or true up for each category	Asset management repex
No. of non-PE services replaced (linked to mains replacement)	Total # of services transferred and re-laid	Total # of services transferred and re-laid +/-X%	No output target – indicative forecast w/ volume drivers for relay and transfer or true up	
No. of non-PE services replaced (linked to non-mains replacement)	No output target – indicative forecast w/ volume driver	No output target – indicative forecast w/ volume driver	No output target – indicative forecast w/ volume driver	
NARMS*	TBD	TBD	TBD	Output targets set elsewhere in price control

*still under development for GD2 through ongoing consultation process

1. Remove existing (MRPS) risk-based output measure

We are considering discontinuing using the risk-based output measure for repex, on the basis that:

- The absolute level of risk on the network is at already historically low levels, and further incremental declines will be comparatively small
- Feedback from WGs and research studies highlight environmental and network operating efficiency as being key drivers of consumer value for the repex programme, with risk reduction contributing a relatively small share of monetized benefits.
- Risk will continue to be removed as the remaining iron mains population is replaced over the final 11 years of the IMRP.
- It is consistent with the overall objective of simplifying the price control.

This remains a primary output for RIIO-GD1 and assessment of performance will remain subject to GD1 closeout

2. Remove fracture/failures and GIBs outputs

We considering removing the fractures & failures and gas in buildings (GIB) output measures for repex, on the basis that:

- There may be significant influence from outside factors which drive these (e.g. weather, traffic flow)
- The accurate reporting of these measures may be reliant on unpredictable external factors, raising questions around the reliability of data for setting targets.
- Baselining an efficient level could be challenging due to influence of weather.

We propose to continue to record fractures, failures, GIBs and incidents data in the RRP, as it remains useful as a lagging indicator for potential emerging safety issues, but there will not be an output attached to it.

This remains a secondary deliverable for RIIO-GD1 and assessment of performance will remain subject to GD1 closeout

Detail of output targets under option 1

Output	Output target	Additional information
Length of main off-risk: <i>Tier 1 volumes</i>	Km abandoned (in line with HSE targets)	
Length of main off-risk: <i>Tier 2A & non-standard materials volumes</i>	No output target – indicative forecast w/ volume driver	No target assigned, reflecting inherent uncertainty in forecasting
Length of main off-risk: <i>Tier 2B/ Tier 3/steel mains/>30m iron/elect <2" steel mains volumes</i>	Km abandoned for each category	Targets for each category based on BPs and Ofgem adjustments. Justified through CBA
No. of non-PE services replaced (linked to mains replacement)	Total # of services transferred and re-laid	Targets based on BP submissions and Ofgem adjustments.
No. of non-PE services replaced (linked to non-mains replacement)	No output target – indicative forecast w/ volume driver	No target assigned, reflecting inherent uncertainty in forecasting
NARMS	TBD	Targets should be consistent with outputs in above categories

- This proposed option would have a number of volume-based output targets.
- Targets would be absolute, with clearly outlined penalties for failure to achieve workloads.
- Workload targets would be set ex ante, based on Business Plan submissions, including any adjustments made by Ofgem.
- Where there is uncertainty in forecasting workload volumes (e.g. Tier 2A), no output target would be set, and in-period adjustments would be made to account for any work actually undertaken.

Option 1: Ensuring workload delivery

Output	Output target	Uncertainty mechanism(s)	Incentive mechanisms
Length of main off-risk: <i>Tier 1 volumes</i>	Km abandoned (in line with HSE targets)	HSE policy changes. Potential PCD clawback.	HSE enforcement if non-delivery.
Length of main off-risk: <i>Tier 2A & non-standard materials volumes</i>	No output target – indicative forecast w/ volume driver	Volume driver adjustment to account for forecasting uncertainty.	HSE enforcement if non-delivery.
Length of main off-risk: <i>Tier 2B/ Tier 3/steel mains/>30m iron/elect <2" steel mains volumes</i>	Km abandoned for each category	None specific to output target, which is fixed. HSE policy changes (if applicable).	Penalty for under delivery. No additional funding in GD3.
No. of non-PE services replaced (linked to mains replacement)	Total # of services transferred and re-laid	None specific to output target, which is fixed. HSE policy changes (if applicable).	Penalty for under delivery. No additional funding in GD3.
No. of non-PE services replaced (linked to non-mains replacement)	No output target – indicative forecast w/ volume driver	Volume driver adjustment to account for forecasting uncertainty.	-
NARMS	TBD	TBD	TBD

Defined of output targets under option 2

	Output	Output target	Additional information
Mandatory	Length of main off-risk: <i>Tier 1 volumes</i>	Km abandoned (in line with HSE targets)	
	Length of main off-risk: <i>Tier 2A & non-standard materials volumes</i>	No output target – indicative forecast w/ volume driver	No target assigned, reflecting inherent uncertainty in forecasting
	Length of main off-risk: <i>Tier 2B/ Tier 3/steel mains/>30m iron/elect <2" steel mains volumes</i>	Km abandoned for each category +/-X%	Targets for each category based on BPs and Ofgem adjustments. Justified through CBA ex ante. Threshold around target to allow some in-period flexibility on workloads.
Asset management	No. of non-PE services replaced (linked to mains replacement)	Total # of services transferred and re-laid +/-X%	Targets based on BP submissions and Ofgem adjustments. Threshold around target to account for uncertainty of forecasting services workloads and ability to trade of £R.
	No. of non-PE services replaced (linked to non-mains replacement)	No output target – indicative forecast w/ volume driver	No target assigned, reflecting inherent uncertainty in forecasting
	NARMS	TBD	Targets should be consistent with outputs in above categories

- This proposed option would have a number of volume-based output targets, with a mix of absolute and threshold stipulations.
- The target for Tier 1 workloads would be absolute.
- Targets for other categories would have an ex ante threshold applied, to allow for some in-period flexibility in workloads.
- Volume driver would be used to adjust cost allowances for variations in workloads, within the threshold values.
- Penalties would apply for non-delivery below threshold values.
- Workload targets would be set ex ante, based on Business Plan submissions, including any adjustments made by Ofgem.

Option 2: Semi-flexible asset management

Output	Output target	Uncertainty mechanism(s)	Incentive mechanisms
Length of main off-risk: <i>Tier 1 volumes</i>	Km abandoned (in line with HSE targets)	HSE policy changes. Potential PCD clawback.	HSE enforcement if non-delivery.
Length of main off-risk: <i>Tier 2A & non-standard materials volumes</i>	No output target – indicative forecast w/ volume driver	Volume driver adjustment to account for forecasting uncertainty	HSE enforcement if non-delivery.
Length of main off-risk: <i>Tier 2B/ Tier 3/steel mains/>30m iron/elect <2" steel mains volumes</i>	Km abandoned for each category +/-X%	Threshold around target. Justification required for delivery outside of this. Volume drivers to true-up cost allowances with workloads.	Unjustified under delivery penalised. Unjustified over delivery not funded.
No. of non-PE services replaced (linked to mains replacement)	Total # of services transferred and re-laid +/-X%	Threshold around target. Justification required for delivery outside of this. True up to adjust cost allowances for transfer:relay split.	Unjustified under delivery penalised. Unjustified over delivery not funded.
No. of non-PE services replaced (linked to non-mains replacement)	No output target – indicative forecast w/ volume driver	Volume driver adjustment to account for forecasting uncertainty.	-
NARMs	TBD	TBC	TBC

Defined of output targets under option 3

	Output	3. Flexible asset management	Additional information
Mandatory	Length of main off-risk: <i>Tier 1 volumes</i>	Km abandoned (in line with HSE targets)	
	Length of main off-risk: <i>Tier 2A & non-standard materials volumes</i>	No output target – indicative forecast w/ volume driver	No target assigned, reflecting inherent uncertainty in forecasting
	Length of main off-risk: <i>Tier 2B/ Tier 3/steel mains/>30m iron/elect <2" steel mains volumes</i>	No output target – indicative forecast w/ volume driver or true up for each category	Indicative forecasts only based on BP submissions, no specific output targets. In period workload adjustments and end of period true up to align cost allowances with outturn workloads.
Asset management	No. of non-PE services replaced (linked to mains replacement)	No output target – indicative forecast w/ volume drivers for relay and transfer or true up	
	No. of non-PE services replaced (linked to non-mains replacement)	No output target – indicative forecast w/ volume driver	
	NARMs	TBD	Targets consistent with £R risk reduction laid out in BPs

- This proposed option would only have a specific output targets for Tier 1 workloads, with the rest of repex workloads left to the discretion of the GDNs to manage through the course of the price control.
- The target for Tier 1 workloads would be absolute.
- The GDNs would still have meet NARMs risk reduction target, based on workload submissions provided in BPs.
- An in-period adjustment mechanism, based on ex ante unit costs, would be used to align cost allowances and allowed revenues with outturn workloads.

Option 3: Flexible asset management

Output	Output target	Uncertainty mechanism(s)	Incentive mechanisms
Length of main off-risk: <i>Tier 1 volumes</i>	Km abandoned (in line with HSE targets)	HSE policy changes	HSE enforcement if non-delivery. No additional Ofgem action.
Length of main off-risk: <i>Tier 2A & non-standard materials volumes</i>	No output target – indicative forecast w/ volume driver	Volume driver adjustment to account for forecasting uncertainty	HSE enforcement if non-delivery. No additional Ofgem action.
Length of main off-risk: <i>Tier 2B/ Tier 3/steel mains/>30m iron/elect <2" steel mains volumes</i>	No output target – indicative forecast w/ volume driver or true up for each category	In-period volume driver adjustments or ex-post true up to account for workloads delivered	
No. of non-PE services replaced (linked to mains replacement)	No output target – indicative forecast w/ volume drivers for relay and transfer or true up	In-period volume driver adjustments or ex-post true up to account for workloads delivered	
No. of non-PE services replaced (linked to non-mains replacement)	No output target – indicative forecast w/ volume driver	Volume driver adjustment to account for forecasting uncertainty.	-
NARMS	TBD	TBD	TBD

Possible advantages and disadvantages of each option

	Option 1: Ensuring workload delivery	Option 2: Semi-flexible asset management	Option 3: Flexible asset management
Advantages	<ul style="list-style-type: none"> Increased certainty around workload profiles and cost allowances Easier to administer through price control Ties network companies more closely to BPs More predictable impact on consumer bills 	<ul style="list-style-type: none"> Maintains focus on quality of BP submission, but allows greater flexibility to adjust to in-period changes Still broadly compatible with meeting targets under NARMs and other indirect outputs 	<ul style="list-style-type: none"> Allows for optimisation of asset management interventions Reduces regulatory burden Most compatible with idea of trading monetised risk between asset classes
Disadvantages	<ul style="list-style-type: none"> Reduced ability to react to dynamic changes in network and consumer requirements Limits scope for risk trade-off under NARMs 	<ul style="list-style-type: none"> Increased complexity in terms of administering the adjustments to cost allowances within the price control period Potential difficulty in aligning value of trade-offs between different types of workloads 	<ul style="list-style-type: none"> Greater scope for avoiding difficult or expensive projects May create short-termism, with greater focus on immediate cost implications Less certainty on impact on consumer bills, potential for volatility Increased complexity to administer

What are your views on our strawman positions?

Which of the possible outputs options is preferred, and why?

Do you agree that these proposals align with the proposed objectives of the price control and the repex programme?

Are there any areas where you feel that you need further clarity?

Our core purpose is to ensure that all consumers can get good value and service from the energy market. In support of this we favour market solutions where practical, incentive regulation for monopolies and an approach that seeks to enable innovation and beneficial change whilst protecting consumers.

We will ensure that Ofgem will operate as an efficient organisation, driven by skilled and empowered staff, that will act quickly, predictably and effectively in the consumer interest, based on independent and transparent insight into consumers' experiences and the operation of energy systems and markets.