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Repex WG 5

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1. Tier 1 Mains PCD

2. Services

3. Relevant Bespoke Outputs

4. HSE Reopener

Purpose of meeting

- Provide an update on initial policy development
- Walkthrough of initial thinking on possible output mechanisms
- Provide opportunity for stakeholder views (both at meeting and after)

Purpose of slides and material provided

- Provide opportunity to review initial policy thinking and associated questions in advance of the meeting

- **All proposals remain in development and are subject to change ahead of consultation at Draft Determinations**

- Present additional detail to aid quality of discussion at working group.

1. Tier 1 Repex - Initial Policy Thinking

Contents

- Overview of SSMD decisions
- Initial thinking on Tier 1 PCD Structure
- Diameter Band Adjustment Mechanism – initial thinking on
  - Structure and Methodology
  - Cost Adjustment Process
  - Link between PCD target and Adjustment Mechanism
  - Treatment of over/underdelivery
- Interaction with NARM

Overview of SSMD decisions

- We said that there would be a PCD for km of Tier 1 mains abandoned (excluding steel ≤2”), based on agreed HSE volumes plus dynamic growth. This would not include a funded deadband for total abandoned kms.

- There would be a restriction on diameter band mix within the target, but the form of this would be decided later as it will be dependent on the approach to cost assessment.

- Costs would be adjusted down for any under-delivery; any delivery of workload above the target would not be funded through the PCD but would instead count towards the NARM target.

Initial thinking on Tier 1 PCD structure – definition of target and target setting

- The targets will likely be defined as described in the SSMD and based on the volumes submitted in the BPDTs (subject to our assessment that these meet IMRRP minimum requirements and that proposed accelerated programmes are considered to be justified).

- We considering whether to fund a flat workload profile through to 2032, or whether to allow funding for accelerated profiles in GD2 (where proposed).

- We are proposing to set targets across GD2 as a whole, though we will track progress on an annual basis via the RRPs.

- We expect under-delivery to be a matter for HSE enforcement. While we stated in the SSMD that we will not apply any financial penalty to under-delivery, we are still considering whether to put in place a reputational penalty. This would likely take the form of a report deliverable to Ofgem, explaining why the GDN has failed to meet its target level of Tier 1 abandonment and what impact this has/will have on customers.

- We expect over-delivery workloads to be allocated to the NARM, as per the SSMD.

What are you views on the overall structure of the Tier 1 PCD?

What are your views on our thinking for over/underdelivery against the PCD target? In particular what are your views on a reputational penalty for under-delivery?

Diameter band restriction

- We are considering including a **Diameter Band Adjustment Mechanism (DBAM)** as part of the PCD, to ensure that outturn costs reflect outturn workloads.

- The DBAM would set a "value" (and hence upfront allowance) for the allowed workload, based on the proposed diameter band mix (see next slide). At closeout, costs would be adjusted to reflect the value of the outturn workload.

- Costs would be set on the basis of mains laid, whereas the overall PCD and HSE targets would be set on the basis of mains decommissioned (abandoned).

The DBAM "value" would be calculated on a bottom-up basis, as in this example:

Diameter band	Unit cost (£m/km)		km laid		Value (£m)
a. <=75mm	0.10	X	800	=	80.0
b. >75mm to 125mm	0.16	X	600	=	96.0
c. >125mm to 180mm	0.21	X	300	=	63.0
d. >180mm to 250mm	0.28	X	80	=	22.4
e. >250mm to 355mm	0.35	X	20	=	7.0
				Total	**268.4**

- The DBAM value would be calculated separately for each GDN, based on its proposed diameter band mix for RIIO-GD2
- Unit costs would be GDN-specific, based on the final allowance for each GDN, disaggregated from totex level back to diameter band level.

At closeout, outturn value would be calculated using the **ex ante** unit costs multiplied by the delivered workload for each diameter band.

Hence, only outturn variations in workload mix would result in changes to the DBAM value.

		Targets		**Outturn**	
Diameter band	Unit cost (£m/km)	km laid	Value (£m)	km laid	Value (£m)
a. <=75mm	0.10	800	80.0	850	85.0
b. >75mm to 125mm	0.16	600	96.0	575	92.0
c. >125mm to 180mm	0.21	300	63.0	280	58.8
d. >180mm to 250mm	0.28	80	22.4	80	22.4
e. >250mm to 355mm	0.35	20	7.0	15	5.3
Total		**1,800**	**268.4**	**1,800**	**263.5**

- In this example, costs would be adjusted down by £4.9m

Do you have any comments on the outlined structure for the DBAM mechanism?

Do you have any questions on how the DBAM value is calculated?

Linking lay to abandon

- The Tier 1 target would be set on kms abandoned, but costs would be set on kms laid. The DBAM would therefore need to include a means of linking these together.
- We think this can be done mechanistically while still incentivising the right behaviours
- We are keen to ensure that GDNs are paid for work they complete, while having incentives to deliver efficient projects
- We also want to ensure that there is an incentive for GDNs to undertake abandon only actions, should the need/opportunity occur during GD2

Example of DBAM calculations

(Note: at the working group we intend to talk through an example how we think the lay:abandon relationship would work)

Questions on linking lay to abandon

Do you have any comments on the outlined structure for linking lay to abandon within the DBAM mechanism?

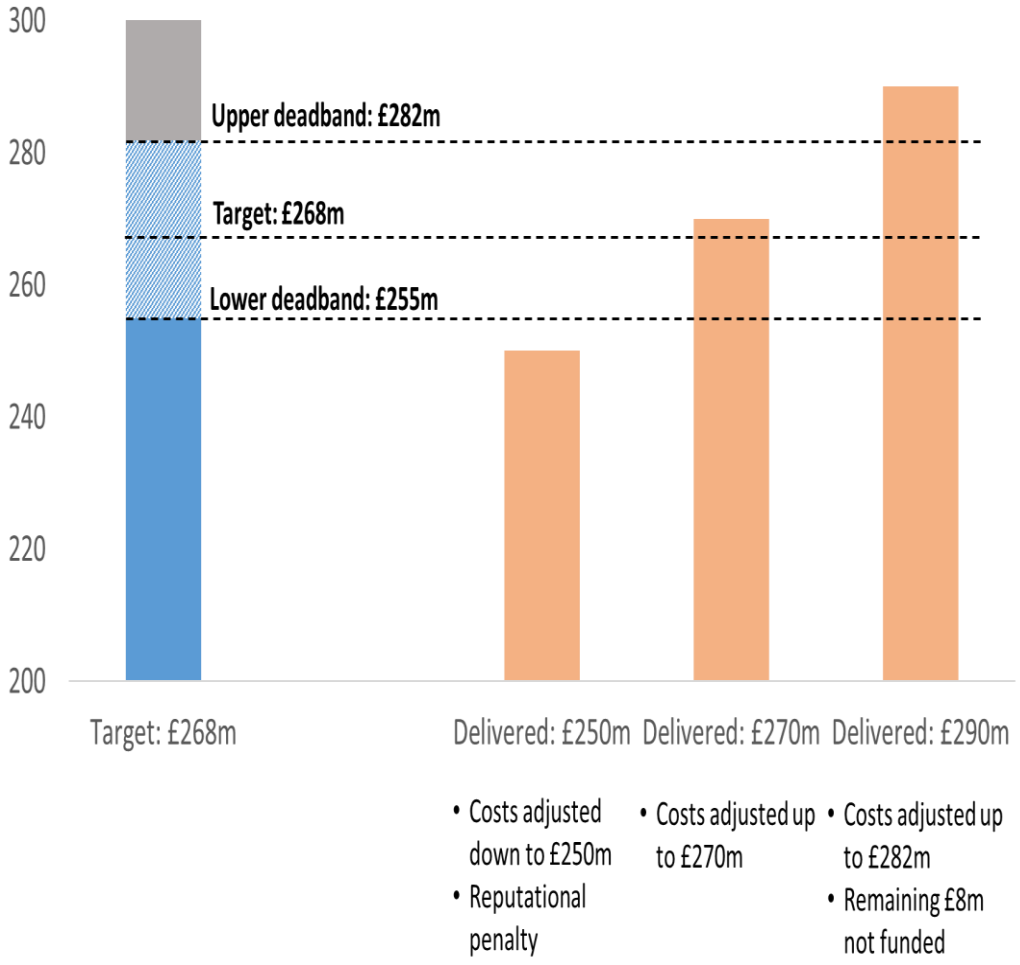
What are your views on how best to account for any differences in the outturn lay:abandonment ratio?

DBAM treatment of over/underdelivery

We are considering setting a restriction on the range of outturn values of the Tier 1 programme, set as a % of the initial allowed value. In effect, this would create a funded deadband.

Over-delivery would result in costs being adjusted to the upper level of the range, with any additional work not funded by the PCD.

Under-delivery would result in costs fully adjusted to reflect the outturn value, with an additional reputational penalty.



What are you views on our thinking for over- and under-delivery against the DBAM value?

Interaction with the NARM

- In SSMD we noted that Tier 1 mains, up to the target covered by the PCD, would be ringfenced from the NARM
- We proposed that the monetised risk benefit for over-delivery of Tier 1 mains workloads will count towards the NARM target
- Any adjustments to allowances would then be covered under the NARM, as part of broader RIIO-2 NARM policy (outside the scope of this WG)

What are you views on our proposal to include over-delivery within the overall NARM target?

Our initial view is that all adjustments to cost allowances would be made as part of RIIO-GD2 closeout, rather than on an annual basis.

We expect there to be annual variation, in terms of diameter band mixes, due to specific project characteristics.

However, we expect GDNs to manage these variations so as to broadly even out over the course of the price control and therefore deliver within the DBAM range.

Do you agree that we should make changes to cost allowances as part of RIIO-GD2 closeout?

2. Services Policy

SSMC/SSMD summary

At SSMC, we consulted on 3 options for a services output:

- A PCD with a fixed target for total non-PE service replacements in RIIO-GD2.
- A PCD as above, but with a deadband threshold of +/-x% around the target.
- No PCD; services would instead be included within the NARM.

Responses were mixed, with GDNs raising concerns that workload uncertainties made setting a PCD target difficult. One GDN proposed a volume driver as an alternative. Other stakeholders were more in favour of a PCD.

At SSMD, we noted that given the uncertainties around workloads a fixed target could create financial risk. We also said we would postpone this decision until we had determined the approach for services cost assessment (which in turn required analysis of the BPDTs).

Our initial view is that a **PCD with a funded deadband** would best meet our requirements for this output:

- Setting a target through a PCD would help to ensure that companies reduce risk via service replacement in line with HSE objectives.
- A PCD would maintain the incentive to outperform ex ante unit costs and creates a reputational incentive for GDNs to ensure broadly consistent workloads are delivered over time.
- Using a funded deadband would allow for some volume uncertainties and provide flexibility for efficient project delivery.
- A PCD would be consistent with the approach outlined above for Tier 1 repex.

The PCD would:

- Designate the volume, in number of interventions, of repex services to be delivered during RIIO-GD2, and would provide baseline funding for RIIO-GD2 forecast workloads.
- Be assessed on a whole RIIO-GD2 basis, rather than annually.
- Apply only to services associated with Tier 1 mains replacement (inc. steel mains <=2”).
  - Our initial view is that services associated with other mains replacement activities and not associated with mains replacement would be funded and incentivised separately

What are your thoughts on the approach of using a PCD with a funded deadband?

Should a PCD target for repex services be set on the number of non-PE replacements or for total service interventions, with an adjustment mechanism to correct for outturn relay:transfer ratio?

What are you views on a PCD only applying to services associated with Tier 1 mains replacement?

Calibration of the deadband

Initial views on calibration:

- A restriction would apply to the total volume of service interventions, set as a +/- percentage range.
- This range would act as a funded deadband, with total costs being adjusted to outturn volume at the end of RIIO-GD2.
- Unit costs would be set on an ex ante basis and would remain the same for any future adjustments.

What could the size of any deadband be and how could the upper and lower thresholds be determined?

Should we consider applying a common deadband threshold (in % terms) across the industry?

What are your views on making adjustments to allowances as part of GD2 closeout, as opposed to on an annual basis?

Consequences of delivery outside the deadband

Under-delivery

- Costs would be adjusted to reflect the workloads delivered, as within the deadband.
- We are considering whether there should also be a financial penalty and/or a reputational penalty applied.
- For the reputational penalty, we are considering requiring GDNs to submit a report to Ofgem outlining why they failed to meet the minimum level and what impact this has/will have on customers.

Over-delivery

- Costs would be adjusted up to the upper level of the deadband. Additional workloads would count towards the company's NARM target, but would not receive additional funding under the PCD

Our initial view is that services not covered by the PCD or other funding mechanisms would also count towards the NARM.

Questions on over/under delivery

What are your views on including a financial penalty for the under-delivery of services below the lower bound of the deadband?

What are your views on including a reputational penalty that would apply in the case of under-delivery of services below the lower bound of the deadband?

What are your views on including services delivered above the upper bound of the deadband in the NARM target?

What are your views on including services not covered by the PCD within the overall NARM target?

3. Overview of potentially relevant bespoke proposals

Accelerated Tier 1 programme

- Proposed by SGN
- Stakeholder support for delivering additional 40km decommissioning p.a.

<=2” steel volume driver

- Proposed by SGN
- Density of <=2” steel not accurately mapped so volume driver allows for uncertainty.

Tier 1 iron stubs

- Differing approaches proposed by GDNs
- HSE decision needed before common approach can be decided on

4. HSE Policy Reopener – Licence Drafting

Background

Within the Sector Specific Methodology Decision we decided to put in place a re-opener mechanism covering changes to HSE policy affecting the Repex for RIIO-GD2.

We have been working on the licence drafting for this reopener and have created a work in progress draft to aid discussion at the working group.

The structure of the document is similar to the Heat Policy Reopener which has been discussed at previous Licence Drafting Working Groups.

Key Elements of the rough initital Drafting

The drafting details two scenarios:

- A reopener activated by the Authority or
- A reopener requested by the Licensee

Licensees may make an application for the price control for the reopener to be activated at any time during the first three years of the price control should it be aware of any changes to HSE policy that materially affects its ability to deliver its Repex Licence obligations.

Ofgem will consider any changes to HSE policy that happen in the final two years of the price control as part of close out.

What is included within the scope of the reopener

We are currently considering the scope of the condition. Our initial view is this will include the following:

a) Any changes made to the Licensee's HSE Approved Programmes; or
b) Any material changes made to "Repex Related HSE Policy Areas".

Question: Does the group have any views on this scope?

Question: Does the group have any views on whether the term "Repex Related HSE Policy Areas" requires further definition?

Question: Should any definition mention any of the following regulations?

- Pipeline Safety Regulations 1996 Regulation 13A;
- The Gas Safety Management Regulations 1996;
- Pressure System Safety Regulations 2000;
- Health and Safety at Work Act; and
- Control of Major Accident Hazards

Next Steps

Once we have developed further the drafting of the Licence Condition we will present this to the Licence Drafting Working Group.

Our current plan is to be able to present this at the May Meeting.

We **will not** be including this reopener as part of our March informal licence consultation. We plan for the drafting to form part of our September informal consultation.

- Please provide any additional feedback on topics discussed today by email to callum.mayfield@ofgem.gov.uk or duncan.innes@ofgem.gov.uk

- Final proposals on policy design presented at Draft Determinations

- HSE reopener to be discussed at licence drafting working group

- First drafts of Tier 1 PCD and Services PCD licence conditions to be taken to licence drafting WGs

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