

RIIO-2 Gas Transmission Cost Assessment Working Group

From: Jon Sharvill

Date: 19-09-2018

Time: 9:30-15:30

Location: Energy Networks
Association, 4 More London
Riverside, London, SE1 2AU

1. Present

Martin Siner, Kelvin Hui, Kiran Turner, Alena Fielding, James Santos-Mansur, Jon Sharvill, James Veaney (external) (Ofgem)

Martin Watson, John Perkins, Alison Robinson (National Grid) (NGG)

Julie Cox (Energy UK)

Gregory Edwards (Centrica)

Bill Reed (RWE)

Alison Langford (Exxon)

John Costa (EDF)

2. Item 1: Timeline for activities and deliverables

2.1 The timeline for the High-Level RIIO-2 Plan was outlined, with this working group contributing towards the Sector Specific Methodologies Consultation in December. Current expectation is that drafts for business plans will be delivered in summer 2019, with formal business plan submission due in Q4 2019.

2.2 Concerns were raised that some stakeholders had not been involved in previous consultations up until now, and some attendees confirmed this was the first meeting they had been invited to. An issue was highlighted with invitations for cross-sector groups not being delivered and stakeholders not knowing what had been discussed at previous meetings. It was noted that it seems late to be starting this process now and not enough time has been given to discuss relevant issues. It was suggested that it would be helpful if working groups are coordinated within Ofgem to avoid timetable clashes where stakeholders have to choose one working group at the expense of others.

2.3 Ofgem confirmed it will tighten up on the cross-sector stakeholder list and ensure today's attendees are on the list for other cross sector groups. Ofgem acknowledged engagement could be improved and will strive for better stakeholder communication in future, while noting that it is somewhat restricted by timelines and the practicalities of running four price controls in a condensed period.

Action: Update stakeholder lists

Person: Ofgem

By: ASAP

3. Item 2: Purpose of Working Group

3.1 The purpose of the working group was explained to the attendees, with the focus being to inform GT business plan submissions; inform development of analytical techniques for the assessment of the business plan; for Ofgem, NGG and other stakeholders to jointly inform the development of a toolkit approach for assessing efficient costs in the RIIO2 business plan; and to work out the practical implementation of performance monitoring through the course of RIIO-2

3.2 It was asked what was meant by 'whole systems', and explained that it is the idea that an action taken by a company in one sector could reduce costs that may be arising in another sector, and the outcome is a reduction in costs across all systems. Stakeholders stated it would be an idea to look at this across GT, GD, and Electricity TO and SO and enquired whether if it required legislative change whether that would be an obstacle. Ofgem said that it could be, but if tangible benefits can be identified that benefit consumers in the cross-sector approach then it should be looked at.

4. Item 3: RIIO-2 Cross-Sector Development

4.1 The current cross-sector policy development review was outlined, as per slide 13 of the slidedeck presentation (attached), giving a short summary of the areas that form the basis of the cross-sector policy.

4.2 Stakeholders asked what were Ofgem's intentions on future scenarios. Ofgem responded that it was looking towards a more unified and consistent cross-sectoral base scenario so that benchmarking can be more easily identified. Ofgem added that it is less critical what scenario is chosen, it is more important that everyone works from the same scenario and each sectors understands what will be done if the future does not plan out as hypothesised. One stakeholder that a range of future scenarios should be considered, rather than one base scenario. Ofgem stated that it is a matter of risk – how much risk are we willing to put on consumers and what can be done to mitigate that risk?

5. Item 4: Framework Decision

5.1 Ofgem outlined its review into RIIO-2 output categories and its proposal to consolidate the existing six categories into three new categories – Improve the Customer Experience; Support the Energy System Transition; Improve the Network and its Operation - that better describe the overall output package, as per slides 19 to 26 of the slide deck.

5.2 It was asked if these categories align with the eight stakeholder priorities identified by NGG at Ofgem's behest, and whether Ofgem agreed with these stakeholder priorities. Stakeholders stated that unless the eight stakeholder priorities map directly onto one of these three outputs there may be difficulties down the line when allocating costs. Concern was raised that a situation could arise where at the eleventh hour Ofgem decided the eight stakeholder priorities identified

were not acceptable. Ofgem acknowledged stakeholder concerns, and emphasised that the intention is for these output categories to be cross-sectoral and not specific to GT. It was explained that these are only initial thoughts and are output categories rather than specific outputs, and the streamlining is aimed at achieving cross-sectoral consistency. Ofgem state that the onus is on NGG to demonstrate that they have carried out robust stakeholder engagement to identify their stakeholder priorities and offer their business plan. A Challenge Group has been created to check the proposals and ensure stakeholder engagement is sufficiently stretching, and a decision will be made based on the business plan and the quality of engagement undertaken.

5.3 Stakeholders observed that there are cases, for example residual balancing and NOMs, where outputs and incentives may fall between categories or do not appear to fit naturally into any of the three categories. Stakeholders asked whether existing incentives and outputs are being retained, as outputs that fit with the current incentive framework do not appear to fit neatly into the new categories. It was requested that Ofgem be clear exactly what is meant by each description. Ofgem accepted these views, stating that the aim is to achieve cross-sectoral consistency, and the output categories are hoped to be sufficiently broad that whatever is proposed in each sector can be placed into one of the categories. Ofgem stated that if there is something specific that stakeholders want from a TO output then that should not be excluded. Stakeholders stated that a balance needs to be drawn between having broad categories and having the categories actually meaning something. Ofgem acknowledged that clarification may be needed on the sector specifics of the outputs, for example 'for a TO this means X, for an SO this means Y'. Stakeholders reflected that customers are those directly connected to the network – large transmission connected consumers/generators, DNs, storage, interconnectors and terminal operators, rather than end consumers connected to the distribution network.

5.4 Stakeholders questioned whether there would be incentives placed against these outputs, and whether incentives should only be placed on things getting better rather than on maintaining current levels of service. Ofgem stated that it is feasible that there are no incentives against these outputs, and it boils down to the measurement of the service that has been provided and what consumers are willing to pay for any improvements in terms of baseline allowances.

5.5 Ofgem outlined the July framework decision that set out the three types of outputs for RIIO2 – License Obligation (LO), Price Control Deliverable (PCD), Output Delivery Incentive (ODI) – as per slide 21 of the slide deck.

5.6 Issues with PCDs in RIIO1 were discussed, with Ofgem highlighting issues with ensuring consumers get their money back if a PCD is not delivered fully, or where underspends in certain areas are not linked to efficiencies but to projects that were amended or did not take place, as it was not clearly established what happens if future planned work is not subsequently required and how to claw money back. Some Stakeholders felt the language was negative and the policy downside-only. Stakeholders identified the need for balance and flexibility in achieving outcomes that may differ from how it was laid out in the business plan.

5.7 Stakeholders asked who had the responsibility for developing the specific outputs. Ofgem responded that NGG are leading on this with input from Ofgem and a review of NGG's performance.

5.8 Stakeholder raised the issue regarding the misalignment of the timing of the gas year and regulatory year. The gas year begins at on October 1 (when purchase contracts begin), whilst the updates to base revenues across Ofgem's price controls which impacts the subsequent charging regime ends later in the year. This leads to charges being set from October having to consider the second part of one year and the first part of the next regulatory period, which tends to lead to a see-saw effect in prices which is difficult to predict and reflect in customer charges. Stakeholders raised the possibly of savings to consumers through better alignment. Stakeholders and Ofgem wished to better understand this issue and Ofgem propose to call for more evidence

Action: Call for evidence for benefits of alignment of gas year

Person: Ofgem

By: ASAP

5.9 Stakeholders broached the possibility of introducing competition and market-led solutions into some aspects of the GT network, for example the building and operation of compressors, as happens in the electricity sector where large savings due to competition have been identified. It was also noted that market-led solutions may be used to deal with assets as a result of the declining demand in the gas industry. Ofgem stated that if there are areas where competition can benefit consumers then Ofgem supports this wherever possible when it leads to a net benefit to consumers. Ofgem acknowledged that in some instances the cost of running competition is high and it may be counterproductive below a certain level. Considerations were also raised around the time and cost involved in establishing frameworks and competition rules, and that if third parties operate on the gas network it will affect other SO incentives.

5.10 Stakeholders confirmed that there is a process underway for forecast contract capacity to be included as part of the charging regime change in the electricity sector, and enquired as to whether this can be aligned to gas, and if so stated that there should be an incentive attached to drive the accurate forecast of contracted capacity, as this will impact predictability and stability of transmission charges. Ofgem replied that this is something that should be looked at, while acknowledging the difficulty in doing so and questioning how the incentive would be set.

5.11 Stakeholders asked what Ofgem's approach is to uncertainty, whether this is part of the reopener mechanism and whether the revenue drivers are going to be reviewed. Ofgem stated that the approach is based on what can be done to protect consumers from paying too much and also protecting companies from costs going the other way. Ofgem seeks to strike a balance between responding to future changes and finding efficient ways to deliver what consumers value in a way that does not expose companies/consumers to excessive risk. Ofgem stated that incentives to beat allowances must be robustly benchmarked by Ofgem, and where accurate benchmarking is not possible and Ofgem are reliant on companies for information then more

caution will be shown in offering incentives. Ofgem stated that it will look at RIIO-1 and decide what needs to be done with regard to revenue drivers.

6. Item 5: Review of RIIO-1

6.1 Ofgem presented a review of RIIO-1 focusing on the composition of the RIIO-1 cost allowance, a combined TO and SO performance summary, individual SO and TO performance summaries, the TO cost approach and the SO cost approach, as per the slidedeck.

6.2 Ofgem noted that the overspend is driven by non-op capex expenditure, and that NGG is forecasting an overspend on TO and an underspend on SO, and this is something to bear in mind when setting costs going forward. Stakeholders asked what caused over-estimations of forecasts, . Some stakeholders responded that the figures are not necessarily wrong, as the expenditures are measured against their allowance and not their business plan. Some stakeholders stated that over an eight-year price control with business plans published three years prior to the outset it is difficult to accurately forecast areas like non-op capex and there are no uncertainty mechanisms to deal with it.

6.3 Stakeholders questioned the figures on page 32 of the slide deck and do not recognise the figure of 60% load related expenditure, stating the total figure to be around £30m. Stakeholders asked what contributes to non-load costs, and it was answered that it was largely asset health, compressors and ingrained security solutions.

Action: Check 60% load related expenditure figure

Person: Ofgem

By: ASAP

6.4 Ofgem invited comments on the current approach of using the baseline allowance for upfront funding and an incremental allowance for adjustments to baseline revenue. Ofgem stated that it is doing what it can in terms of benchmarking but there is no consistency, while ACER and CEER are also working on international benchmarking. Stakeholders queried what unit cost assumptions are used for offtakes, and stated that they do not believe there is any allowance for offtakes, and question the idea that for a certain asset you can have a different treatment of it depending on the driver, and requested further clarity. Ofgem acknowledged this and stated that it will come down to the way the RIIO2 cost assessment is approached and the way uncertainty mechanisms are defined. Ofgem invited NG to provide feedback on the slides and detail any issues they have with them so any differences can be aligned.

Action: Highlight issues with information on slides

Person: NGG

By: ASAP

6.5 Ofgem invited views on how the approach taken in RIIO-1 could have better captured the costs, and if there are any approaches that can be improved upon in RIIO-2. Stakeholders queried the distinction between TO and SO investment and how they are all reflected in costs, stating that to be efficient in terms of network investment it must be clearer what is driven by TO and SO, and this must be considered in cost drivers. Stakeholder stated that this will become clearer once the business plan is received, and that they are happy to show with examples in the future. Ofgem

requested that this is done at the next meeting and that NGG explain the reasons why the categories are as they are.

Action: Provide clarity on TO/SO network investment, NGGT to map out cost drivers with allowance area

Person: NGG By: Next meeting

6.6 Some stakeholder asked what indicators or metrics can be used to determine consumer value for money. Stakeholders suggested overall level of service, interruptions, and information provision. Stakeholders asked whether any willingness-to-pay research had as yet been undertaken, to which NGG replied in the negative.

6.6 Ofgem asked how much thinking NGG have done in terms of using parts of the network for storage as structural demand for gas falls. NGG highlighted that storage is currently daily, that there are legal issues with storing gas contrary to the pipelines' specified usage, landowners are not happy with pipes being used for storage, there are issues with pressures, and linepack incentives limit what can be done on a national level, and while NGG are looking at ways to repurpose pipes the current system provides the flexibility and balancing capability that consumers desire.

7. Item 6: Lessons of RIIO-1

7.1 Ofgem outlined some of the lessons learned from RIIO-1 and what areas need improvement in RIIO-2, as per slides 39 to 42, with the key issues being expenditures not linked to outputs, poorly defined outputs, insufficient linkages to related cost categories, and a need to improve cost assessments.

7.2 Stakeholders stated that it is difficult to see if cost allocation is being done consistently. Some stakeholder stated that the detailed guidance determining where each cost must be put and they supply around 15,000 data items in the RRP, nearly all of which have a defined allocation rule. NGG acknowledged that while costs are clearly demarcated and categorised, this is not always necessarily true with outputs and there is an issue between outputs versus outcomes.

7.3 Stakeholder questioned whether there should be a claw-back mechanism if there is over-performance as this creates a disincentive. Stakeholders noted that NG are constrained by what is in the price control set potentially eight years previously, and stakeholders queried that if outcomes are compliant with the price control but the methods have changed why should they have revenue clawed back. Ofgem asked what parameters can be added around outputs that balance the system so that consumers are not exposed to additional costs/risks and good performance is also incentivised.

7.4 Ofgem raised concerns that the current RIGs reporting does not clearly tell the story of how costs are linked to outputs and that the network is operating in an economic and efficient way, so

it becomes difficult to see what it is that is driving efficiencies and performance, noting a lack of granularity in reporting compared to other sectors. NG acknowledged this, stating that the level of granularity desired by Ofgem is inconsistent with the level desired by NGG's other stakeholders, some of whom consider that the present level of data published is already too dense to draw required information from easily. Stakeholders stated that if the RRP is not currently giving stakeholders the information they need then it will be looked at. Stakeholders felt that they needed an appropriate level of information to engage in areas of interest in providing a resilient, flexible network at a reasonable cost, whilst some areas including safety, cyber security and physical security at critical sites are taken as given and more for debate between Ofgem and NGG.

7.5 Some stakeholders highlighted the issue of stagnation periods under the current model, whereby work is taken to a certain point and then stopped due to uncertainty over whether future funding will be forthcoming. Stakeholders suggested that if NG know what the criteria are for funding and the work meets that criteria then they should have the confidence to undertake the work. Other stakeholders responded that views are subjective and information may be open to different interpretations. Ofgem indicated that these are topics that will be discussed further in future working groups, and if these are areas that stakeholders are interested in Ofgem will direct them towards these working groups.

8. Item 7: Scenario Planning

8.1 Ofgem outlined its plan to take a cross-sectoral approach to future scenarios in order to avoid different sectors working towards different scenarios. The Future working group will determine one baseline scenario with other scenarios possibly acting as counterfactuals, which will be done alongside cost assessments.

8.2 Stakeholders raised the issue of whether a cross-sector approach will be more problematic than sector-specific scenarios, as consensus agreement between all sectors may be difficult to achieve. Stakeholders requested better understanding from asset companies on what the impact will be on their businesses in different scenarios, in particular the range of difference between the scenarios, and also stated the importance of price control allowances that are flexible enough to deal with the changes to the baseline scenario. Stakeholders expressed scepticism as to whether choosing a single baseline scenario is a good idea, and suggested that more uncertainty mechanisms are built in. Ofgem stated that it had not yet chosen a single scenario, and first need to get to grips on the impacts of each and challenge all network over their assumptions that feed into their business plan.

8.3 NGG gave a presentation on their FES overview. It was stated that regardless of which scenario is chosen there is limited scope to act and, for instance, take pipes out of the ground until definitive signals are being sent, and will be producing a document regarding the impact of each of the four scenarios early next year. Stakeholders supported this approach as it would help to identify the cost drivers that were most sensitive in driving outputs and therefore assist the

development of uncertainty mechanisms. Stakeholders recognised a future trade-off between having a bigger more flexible network or having smaller one with a potential drop in capability.

9. Item 8: Cost Benefit Analysis

9.1 Ofgem made a presentation on the need for CBAs, as per slide 45 of the slidedeck.

9.2 Stakeholders had a discussion on the use of CBAs in the GT sector and how they can be used in the context of the price control. Issue raised about using CBA to determine whether assets should be maintained or decommissioned, with the trade-off apparent between consumers paying in the long term to maintain underused/unused assets or paying a lump sum in the short term to decommission assets but losing the asset's capability. A further issue was raised between current and future consumers as to where the costs/benefits of future business plans lie.

9.3 NGG made a presentation on CBAs. Stakeholders stated that it is important to make a distinction between what needs a CBA and what does not, and that they consider CBAs as a support tool rather than as a decision tool. All stakeholders accept that CBAs are a key indicator but also consider qualitative measures that also affect business decisions. Ofgem suggested developing a clear proforma that determines exactly what does/does not need a CBA. Stakeholders enquired whether networks are going to publish CBA results and investment appraisals for a number of schemes so the scale and breadth of investments can be considered, to which NGG responded that they would seek stakeholder verification of all plans and options.

Action:, NGGT to add to the mapping of cost drivers , areas where CBAs are most pertinent

Person: NGG

By: Next meeting

10. Item 9: Next Steps

10.1 NGG to provide clarification on points of disagreement contained within the slidedeck

10.2 NGG to produce document showing impact of each of the four future scenarios

10.3 Ofgem to ensure that stakeholders come to the correct working groups and relay dates of future working groups

11. Any other business

11.1 None

12 Date of next meeting

12.1 October 10th – Policy Working Group. SO incentives and environmental outputs.