

## RIIO-2 Costs & Outputs Working Group

From: Ofgem

Date: 25/09/2018

Location: 10 South  
Colonnade, Ofgem's Office

Time: 10:00 – 17:00

### 1. Present

Ofgem Representatives;

#### Attendee

Paul O'Donovan

Neill Guha

Mark Cassidy

Anthony Mungall

Thomas McLaren

Zak Rich

Item 6 'Scenarios and Forecasting' only

Francesca Caputo

Item 6 'Scenarios and Forecasting' only

Stakeholder Representatives;

#### Attendee

James Kerr

David Bowman

Michelle Clark

Jonathan Ashley

Stewart Lindsay

Paul Leddie

Danny McMillan

Gordon Macdonald

Martin Hill

Craig McTaggart

#### Organisation

Citizens Advice

National Grid Electricity System Operator

National Grid Electricity Transmission

National Grid Electricity Transmission

Scottish Hydro Electricity Transmission

Scottish Hydro Electricity Transmission

Scottish Hydro Electricity Transmission

Scottish Power Energy Networks

Scottish Power Energy Networks

Scottish Power Energy Networks

## 2. Introduction

- 2.1. Ofgem welcomed and thanked stakeholders for attending. Ofgem began by giving a short recap on the purpose of the working group (WG) and reminded them that it was a non-decision making group.
- 2.2. Stakeholders raised a number of queries regarding the business plan (BP) submission timeline, especially on the intention of requiring the submission of a draft BP in July 2019. Ofgem outlined its expectation that this initial draft should allow Ofgem to understand the approach the Electricity Transmission Operators (TOs) intend to take for RIIO-ET2. The final BP submission in December 2019 should then build on the initial draft, but should not feature any unexpected material change.
- 2.3. Stakeholders questioned whether Ofgem had any specification for the initial draft. Ofgem will be publishing an initial guidance, and this will be further developed through discussion from working and engagement groups.

**Action 1:** Circulation of Meeting Minutes.

**Ofgem – Prior to publication**

**Action 2:** Publication of Presentation and Minutes on Ofgem website.

**Ofgem – TBC (depending on technical issue resolution)**

## 3. Cost Assessment Methodology

- 3.1. Ofgem presented on their current plans for the cost assessment methodology. The presentation featured;
  - RIIO 2 framework decisions,
  - RIIO-ET1 cost assessment tools review, and,
  - Initial thoughts on RIIO-ET2 cost assessment.
- 3.2. On Price Control Deliverables (PCDs) stakeholder queried how lower specification was defined. Ofgem outlined that the lower specification would be a deviation away from the expectation defined within BP submission and, if this occurred, TOs would need to provide justification. Conversely, stakeholders noted that delivery to higher specification that provides benefits to the consumer should be recognised as efficient delivery.

- 3.3. Stakeholders then asked how they should approach the mitigation of risk from impacts or changes that occur over the course of the price control. The examples of the NOMs methodology and the political climate were given. Ofgem responded that the TOs need to balance the risk for all parties, i.e. to include consumers and other stakeholders, when designing their BPs. In addition, a suitable level of justification would be required for instances of deviation from the BP targets. Ofgem noted the difficulty it has had in RIIO-ET1 with understanding the context and reasoning for changes to the BP targets and this could be mitigated with understanding how changes deliver justified value to the consumer.
- 3.4. Stakeholders queried how costs would be considered for projects that span multiple price controls. Ofgem set its expectation that Cost Benefit Analysis (CBAs) should be used for justification of a project, over the long term. Ofgem also noted that the monitoring of projects that span multiple control periods would have to be improved.
- 3.5. Ofgem noted that the RIIO-ET1 cost tools would be carried over to RIIO-ET2 and that the analytical methods used will represent an evolution rather than a revolution.
- 3.6. Ofgem raised concerns regarding the cost categorisation, emphasising that clarity is required on what is included within unit cost categorisations. Ofgem's overall aim is to improve the comparability both within and between sectors. Stakeholders agreed; however, they noted that significant work is required to bring them to a suitable level to allow such comparisons.
- 3.7. Stakeholders also mentioned that alignment between the Policy and the Cost and Outputs working groups is required and noted the importance that Ofgem coordinates the activities of the two groups.
- 3.8. Ofgem raised its own thoughts regarding where value has been added in RIIO-ET1 and where there has been unintended outcomes. Stakeholders disagreed that the T1 scenario planning had an unintended outcome as the scenarios were planned using the policies at the time. Ofgem noted that the scale of divergence, from the scenario, was the unintended outcome. For RIIO-ET2, Ofgem set the expectation that for scenario planning, TOs should apply a realistic plan which aims to reduce divergence by setting suitable baselines as close to reality as possible. Ofgem also requested to the TOs to consider how they approach potential, and flex for, material change within their scenario planning.

- 3.9. Stakeholders remarked that for input and output transparency to be achieved, definitions need to be well set. The example was provided that at mid period for RIIO-ET1, a TO expected output was no longer considered to be an output by Ofgem. Stakeholders also mentioned that a degree of pragmatism was required for measuring outputs, as TOs could be delivering hundreds of active projects, making measurement difficult.
- 3.10. Discussions took place on asset health management. Ofgem stated that there is a possibility that it may carry out audits on TO's asset management systems and condition assessments; however, there are no firm proposals in this regard at present. Ofgem raised a future WG discussion topic on how TOs know what condition their assets are in and how they ensure an appropriate level of assurance and governance on asset health and risk.
- 3.11. Stakeholders noted difficulties with the lack of comparability, in terms of setting outputs, within the sector. Ofgem understood the issue of comparability faced by the TOs, however, noted that TOs should make every attempt to achieve comparable sector outputs. Ofgem commented that RIIO-ET2 offered the opportunity to harmonise outputs.
- 3.12. Stakeholders asked how Ofgem envisaged the inclusion of user group in setting outputs and what the general process is. Ofgem commented that its current view of the process as follows;
- User groups input used to develop BPs,
  - BPs submitted to Ofgem where analysis is undertaken,
  - Both the BPs and Ofgem's analysis is presented to the challenge groups for discussion,
  - Areas of contention would be raised at the challenge group panels for discussions.
- 3.13. Ofgem noted that a Business Plan guidance document was to be issued but it would need to be further developed before it could provide the level of detail required for their submissions. The expectation is that the further versions will be informed from the discussions taking place in this WG, so there should be little or no surprises in the final version.

- 3.14. Ofgem outlined its intention to initially review and assess the need for RPEs at a cross sector level, then apply any learnings by sector.
- 3.15. Stakeholders asked for the rationale for Ofgem's focus on inputs for RIIO-ET2. Ofgem confirmed that the primary focus remains on outputs and explained that a greater understanding of the inputs that deliver the outputs improves both its ability to set appropriate allowances for Price Control Deliverables and its understanding of licensees' performance over the course of the price control.
- 3.16. Stakeholders noted that with RIIO-ET2 there is the opportunity to simplify information submissions to improve clarity and transparency. Ofgem agreed with this notion. Stakeholders also stated their preference that mechanisms are designed and agreed by the start of the price control rather than being designed and agreed on during the price control.
- 3.17. Stakeholders queried how monetised risk would be included within RIIO-ET2. Ofgem commented that the decision would be open for group discussion on how monetised risk informs BP frameworks. Ofgem raised its intention to host a separate NOMs cross sector WG group for the week beginning 22nd of October 2018 or the following week.
- 3.18. Ofgem asked TOs to consider the points made in under "RIIO 2 Well Justified (Why/What/How)" and how they would approach these in the BP. In addition, when considering these points, Ofgem asked TOs to apply the same approach they would use for delivering assurance and governance within their organisations to their board of directors.
- 3.19. Ofgem and Stakeholders discussed next steps. Ofgem commented that a joined-up approach should be taken to flesh out some of the ideas presented. Stakeholders commented that consideration is required on firming up the models and methods reflected within their BP submissions. Additionally, Stakeholders outlined the need firm up timelines to allow for the incorporation of better planning for BP development.
- 3.20. Stakeholders asked when are the price control mechanisms planned to be worked on and applied. Ofgem responded that the NOMs mechanism would have its own working group. For generation connections and demand connections, these would be contained within this working group.

3.21. Stakeholders discussed how BP could potentially be assessed. It was noted that over the course of price control, projects included within the BP may not be taken forward, replaced or changed. As such, consideration for a range of outcomes may need to be included within the assessment method. Ofgem will review historical data to inform its assessment of BP submissions.

3.22. Discussion continued on to accuracy of reporting to capture TO performance. Stakeholders commented that currently this is an issue and suggested that for RIIO-ET2 the reporting templates should be built into the mechanisms rather than designed out with. Ofgem commented that the BP should capture any potential change through TOs' asset stewardship.

3.23. Stakeholders reemphasised that the mechanics of the price control cannot be left to the end of the control and should be incorporated at the beginning. Ofgem noted the comment and added that it depends on the quality and content of the BP.

**Action 3:** Ofgem to consider the mechanism process change **Ofgem –**

**Action 4:** NOMs Cross Sector WG to be arranged **Ofgem –**

**Action 5:** Consider what "Well Justified" will look like in their BPs **TOs – Next WG Meeting**

## 4. Cost Assessment and Unit Costs

4.1. SHET presented their approach to project cost estimation and how key cost drivers are incorporated into the process. The firmness of the cost estimate depends on the certainty of delivery; projects at initial stages of conception are estimated at a high level, while those that are going ahead are costed in great detail and backed by firm contracts.

4.2. The meeting discussed the issue of cost predictability and uncertainty in the context of the Framework Decision, which noted that incentivisation levels would be linked to overall cost predictability. Ofgem asked how ETOs managed project cost risk within their own organisation, commenting on the potential for risk to be managed at a portfolio level or by exception. Stakeholders argued that comparisons using templates and data does not fully capture all aspects of project costs.

**Action 5:** Review and feedback on each cost mechanism, including what works well or does not work, for project costs. **Stakeholders – Next Working Group**

## 5. Cost Assessment and Business Plan Data Templates

- 5.1. Ofgem presented its intended approach for assessing cost and its initial proposal on the overarching structure of BP templates. Stakeholders queried whether Ofgem intended to continue with an annual reporting approach or potentially implement a more frequent data submission. In addition, they suggested the potential to segment certain reporting areas, allowing some categories to be reported more frequently and others less frequently. Ofgem commented that it is currently conducting a long-term data services project to improve regulatory reporting. However, this project is at a very early stage and has not yet been fully scoped. Ofgem stated that it was open to reviewing reporting frequency.
- 5.2. Stakeholders mentioned the potential to move away from using descriptions of load and non-load to improve communication of these areas to consumers. Ofgem agreed in principle and asked TOs to think on alternatives.
- 5.3. Stakeholders raised the concern in regards to how customer funded projects are incorporated within the cost category proposals, noting the potential for performance to be skewed with their inclusion. Stakeholders discussed the options available and decided to consider how customer funded projects are categorised.
- 5.4. Stakeholders agreed to a reduction in the number of current cost categories down from nine, however, they raised concerns that three (as proposed by Ofgem) would be too few, specifically when considering resilience. Stakeholders raised the argument that 'weather related resilience' was an indirect impact on TOs and out with their control. Ofgem agreed to consider including an additional 'Resilience' category.
- 5.5. Stakeholders queried whether the Business Plan Data Template (BPDT) proposal to contain annual data for eight years post T2 required an eight year project planning view. If so when would schemes be assessed. Ofgem commented that the projects would be assessed in the five-year price control. Stakeholder outlined that this created the risk of undertaking planning for an eight-year price control and fitting it within a five year version. Ofgem commented that it would take this away for further thought.

- 5.6. Stakeholders asked whether TOs were to submit more than one view for the BP as they were currently working towards their best view. Ofgem suggested sensitivity testing the best view. In addition, they noted that they expected a well-justified five-year program using eight years' worth of data.

**Action 6:** New titles for Load and Non-Load **All – Next Working Group**

**Action 7:** Consider how customer funded projects are categorised. **All – Next Working Group**

**Action 8:** Scope of eight year planning for five year price control **Ofgem – Next Working Group**

**Action 9:** Views to be provided in writing on overall proposals and categorisations **Stakeholders – In two weeks (by 9<sup>th</sup> October)**

**Action 10:** Ofgem to provide sample mock-up templates **Ofgem – Friday before next working group meeting**

## 6. Scenarios and Forecasting

- 6.1. Ofgem discussed with the TOs the best paths forward to reach some consistent views across both gas and electricity networks on the future of the energy system.
- 6.2. Ofgem explained that they, stakeholders, and the RIIO-2 Challenge Group, had expressed a preference for licensees' business plans to be informed by a consistent view of the future of the energy sector across all four network sectors. TOs were concerned that arriving at a single national scenario may not be beneficial to either consumers or licensees and that what is important is ensuring flexibility so that allowances and PCDs can be appropriately adjusted to reflect outturn variations from assumed scenarios.
- 6.3. Additionally, stakeholders noted that network companies need to provide recommendations on managing uncertainty, allowing for reasonable flexibility, which may vary per licensees' sector and location. A single scenario may not allow network companies to appropriately achieve this.
- 6.4. Ofgem confirmed that a teleconference is scheduled for Monday 1<sup>st</sup> October for Ofgem and licensees to discuss this matter in more detail.

## **7. Network Options Assessment**

- 7.1. National Grid Electricity System Operator (ESO) presented on the Network Options Assessment (NOA). The NOA provides one example of how scenarios can be used in recommending investment decisions and is based on the concept of single least worst regret.
- 7.2. The ESO confirmed that the NOA process, and its inputs (e.g. the Electricity Ten Year Statement), consider all of the System Operator's Future Energy Scenarios.

## **8. Next Steps**

- 8.1. Ofgem agreed to present further views on the assessment of RIIO-ET1 costs to inform RIIO-ET2 allowances, with specific initial focus on generation connections. ETOs undertook to present their views of how the data collection templates could be revised to reflect the reduced number of cost categories and assist in the monitoring of performance through the course of the control period.