

RIIO-GT2 Cost Assessment Working Group

From: Scott McDougall

Date: 20-11-2018
Time: 10:00-16:00

Location: Conference Call

1. Present

Kiran Turner, Kelvin Hui, James Santos-Mansur, Craig Molyneux, Scott McDougall, Shankar Rajagopalan (Ofgem)
John Brookes, Adele Hutchings (National Grid)
Julie Cox (Energy UK)
James Kerr (Citizens Advice)

2. Introductions

Participants were introduced. It was explained that all views and opinions will not be attributed in the minutes and it was made clear that all slide decks were intended to provoke thought, discussion, and sharing of knowledge rather than representing fixed policy decisions. It was noted that chatham house rules apply and that due to the nature of the meeting via conference call, written feedback would be accepted for inclusion in the minutes.

3. Cost Assessment Toolkit

3.1 NGG provided a presentation on its emerging process for forecasting and reporting costs within its own business (based on ISO14224) and how that differs from the current information provided to Ofgem as part of the RRP. NGG flagged the additional manual intervention that is required and the impact on its data assurance scores.

Cost reporting

Ofgem asked how NGGT's proposal to use alternative asset categories that aligned with its internal systems linked to Network Asset Resilience Measures (NARMS) and NGG need to flag the purpose of moving asset groups. NG advised this was linked to transparency and simplicity and noted they had a session on NARMS scheduled in January. Ofgem asked if stakeholders have a view on unit cost development, Stakeholders felt that Ofgem need to understand the consequences of moving asset groups and that it could aid transparency, but any changes should be carefully considered.

Action: NGG to set out the proposed reporting structure and the pros and cons / Who: NGG / By: next working group

Action: Ofgem to consider other RIIO sectors reporting and any issues which may arise from changing reporting categories / Who: Ofgem / By: next working group

Cost Drivers

The group agreed that cost categories and unit costs need to be clearly defined given the experience in RIIO-1 with “exceptional” costs for compressors. Some exceptionals are just facts of life and it is important to get the balance right in the level of detail. Stakeholders agreed transparency is improved if it is possible to compare unit costs and noted that “exceptional” events are something of a misnomer.

The difference between other sectors, was discussed, in particular the ability to benchmark between networks. It was noted there is not the need to bring out the detail in unit costs, as much of the inherent variability is present in all companies costs and only true exceptionals must be dealt with; this is achieved through the use of regional factors.

NGG stated they are considering whether it is possible to use external benchmarking to help address the lack of comparitors as they understand the need to justify costs and the onus is on them to do this. They noted they are cautious about this approach as the comparator points must be appropriate and it may find that it isn't possible to do this.

Action: Take offline and define asset categories reporting and cost definitions and drivers for investment, understand what is in scope for particular investments and where the boundary is, what is exceptional and what needs to change ; Who: NGGT and Ofgem via bilaterals ; By: feedback on progress at the next working group

On SO costs drivers, NGG noted these are driven by people and systems and the level of capability required of them. What drives cost is the complexity and what skills they need from people to deliver that. NGG stated this remains a candidate for a historic approach to cost assessment. Ofgem noted that there was a step missing on cost drivers for SO, what are they actually delivering for the costs? NGG confirmed they had considered this having tried to stay away from what drivers volume following feedback at a previous working group. Broadly NGG expect a similar people structure going forward. However, complexity could well increase and if so costs won't be a flat line. Ofgem noted the key thing is the baseline for the SO and what drove these costs and what is currently being delivered, then justify the shift in costs from there.

Stakeholders agreed with the need to baseline costs as a starting point for discussion.

On Business Support costs NGG recognised that this was highly benchmarkable and are preparing for a similar assessment as before using the Hackett method.

Action: Provide baseline for SO costs, what drives these costs and what is currently being delivered, then justify the proposed changes in costs from baseline ; Who: NGGT ; By: next working group

3.2 Ofgem presented views on what makes a good cost driver.

Stakeholders broadly agreed these made sense, but added they should be easy to explain and understand. Ofgem noted it was important to distinguish between investment drivers and cost drivers as they are two different things.

3.3 NGG presented their views on cost assessment approaches.

NGG presented their views on cost categories for RIIO-2 and the group discussed the uncertainty of emerging cost categories. In terms of some of the uncertainty, Cyber is a new challenge and NGG does not have experience of what drives cost in this area so may have to go to the market for solutions. Decommissioning costs are also uncertain as there has not been much done in the past. Ofgem noted there is good understanding of cost assessment approach where we have cost certainty and the uncertain elements highlight areas for focus. Ofgem also noted we are not moving far from RIIO1 approach. Stakeholders felt to take cost assessment forward its just a case of working through the options and that its going in the right direction. Stakeholders felt there was a lot of detail and NGG and Ofgem should work on it and report back.

NGG recognised the that the onus is on it to justify costs and will actively try demonstrate this in its business plan.

Ofgem noted they will do a full cost assessment and while they may consider work NGG have presented it would need to be demonstrably independent and reliable. NGG clarified it would be helpful to ensure Ofgem's requirements are clear up front.

Again stakeholders felt there was a lot of detail and that NGG and Ofgem should work on cost assessment and report back.

Action: Provide feedback on the principles of what makes a good cost driver. Propose a set of cost drivers that should be considered as part of the cost assessment process. | Who: NGGT | By: February working group

Action: NGG to provide details on what cost assessment they propose to undertake for the business plan submission | Who: NGG | By: next working group

4. Business Plan Data Templates

4.1 NGG presented their proposed approach to business plan data template development.

Stakeholders felt simplified reporting was key and agreed it should be consistent and transparent, they also agreed it should link back to NGGs identified stakeholder priorities and also there should be a process for ongoing feedback. Ofgem noted the need to align with stakeholder priorities but within the requirements of a price control and there should still be some alignment between sectors and the key principle of being able to look back at performance against initial allowances must not be lost.

There was agreement that RIIO-1 templates are a starting point and they will evolve for RIIO-2 where there is a key reason for change. NG stressed the point that the structure, objectives and principles of the reporting should be reviewed and agreed on and the T1 templates should then be used in this context. This initial review helping to inform updates in the templates. This evolution may mean more detail in places and less in others, additional information requirements should be assessed for cost of production and benefit/use.

NGG indicated they would like to understand the methodology and what Ofgem will do with the data and how they will assess the plan so that they can best propose changes to the templates.

Ofgem acknowledged that it is important to understand how the data will be used to ensure that it is relevant however the assessment needs to follow the evidence, there will not be a definitive approach. Additionally the assessment will be dependent on the business plan submitted. It was agreed that the structure should be agreed at bilaterals between NGG and Ofgem. Ofgem noted the timescales for business plan submissions will be outlined in the December consultation and NGG raised concerns that timescales will be tight given the need to get board approval.

Action: articulate the difference between innovation, options assessment and ongoing efficiency ;

Who: Ofgem ; By: next working group

Action: provide update on cost assessment approach at next WG ; Who: NGG & Ofgem ; By: next working group

Action: agree the key principles for business plans data template development ; Who: Ofgem & NGG ; By: next working group

Action: NGG and Ofgem discuss template development with reg finance ; Who: NGG & Ofgem ; By: next working group

Action: Agree timescales for BPDT development at bilaterals ; Who: NGG & Ofgem ; By: next working group

4.2 Ofgem presented their view of the general structure of the template sheet

It was noted that there are general difficulties in reconciling proposed vs final allowances at each cost category level and this would be a positive change, but all agreed it would be a big challenge to deliver and perhaps not possible in all areas.

5. Investment Planning

5.1 NGG presented their investment planning approach for SO driven investments

Stakeholders noted the process related to work outside PARCA and questioned how the FES fed through the steps and what links there were with other industries. Stakeholders felt the process should reflect the Network Options Assessment (NAO) in ET and asked if there was a similar public document that outlines the options and what is proposed. NGG stated that there is not a similar public document to the NOA however, the process is designed to look at what capability is needed to support requirements. The Gas Ten Year Statement provides information to help identify connection and capacity on the NTS, summarise key projects and changes that may affect network users. Ofgem related to the points raised by stakeholders that the SO monitors the network and looks at what needs done, and customers drive load related requirements through PARCA. Additionally, there are specific drivers (emission, cyber etc) raised on the TO side and Ofgem questioned how TO derived requirements are captured. NG noted the unique challenge they face as a TO when questioned on the future of assets that is greater than in other sectors. The need to justify TO investment to maintain the system is a new way of looking at things. The main point being that they need to develop the right network for consumers and there is a challenge in getting that right.

Ofgem questioned whether the investment planning was a one off or ongoing process and NGG will check and clarify. Stakeholders agreed that there are three routes to investment, Customer, TO and SO driven, and would like to see this developed as its an important part of the story. Ofgem requested examples for the TO driven investments, specifically for the IED and Feeder 9 decision processes.

There were several questions posed during the session regarding the investment process presented and NGG provided follow up written feedback as outlined below:

What time horizons do we do these studies on? How often do we do them?

Studies are largely trigger based (see below) and therefore new ones arise ad-hoc but will tend to get reviewed annually with FES

Is FES the key trigger? What other trigger might lead us to run the process?

Triggers are described in GTYS: they can include changing customer requirements (changes in behaviour, connections, a new FES); legislation (e.g. IED); asset health (do we need to replace an asset that is end of life)

These are initial triggers; we keep need cases under review and may update our need case analysis on the basis of a new FES if the forecasts are significantly different

Do we study all 4 FES scenarios or do we make some judgement about which to use?

We make a judgement about FES scenarios but also demand levels, supply sensitivities, plant availability etc.

When taking the high level FES scenario and turning them into the point data do we do any other consultation, with GDNs for example?

The process incorporates data provided by GDNs through the annual planning cycle, including flow distribution across offtakes and pressure requirements at lower demand levels.

Action: present the three models for investment (SO, TO, Customer driven) with examples from RIIO-1, specifically Feeder 9 and IED | Who: NGG | By: 14/12/18

6. Cost Benefit Analysis

6.1 Ofgem presented view on key principles for CBA and risks with respect to asset stranding.

NGG want to get the template development completed urgently and it was agreed that the CBA is for stakeholder engagement as well as Ofgem. Stakeholders agreed transparency and consistency was a good thing. The link between the needs case and the CBA was discussed and how they work together. The 24 year timescale for benefits as used in GD was discussed, NG stated that the timescale should be dictated by the useful life of the asset as this may vary widely depending on the asset and a blanket approach was not appropriate. There was some discussion on replace vs life extension work and how to compare these options in a CBA, potentially by annualising the costs.

Action: write down the questions to be answered by CBA, develop templates and be consistent cross sector | Who: Ofgem | By: next working group

7. Cost Definitions

7.1 NGG presented their views on flexibility

The primary driver for this work is the actions taken following the baseline workshop held on the 8th November 2018, NGG indicated this is work in progress and they are still considering all the options. Stakeholders noted that there is an expectation for entry flow rate but not so sure about exit. NGG acknowledged this and will check. Stakeholders noted flexibility is good for consumers and expect GDNs to be involved as they have concerns. NGG confirmed GDNs were present at the baseline session.

It was agreed that defining capability and flexibility was not the role of the CAWG but the group need to understand if there are implications for cost assessment and business planning. It was noted that the impact relates more to the needs case not cost assessment. NGG noted that it's part of how the need will be identified and why a certain thing will be delivered.

Action: provide clarity on approach to defining capability and flexibility ; Who: NGG & Ofgem ; By: 30/11/18

AOB

No additional points were raised.

Summary of Actions Arising

NGG

- *Action: NGG to set out the proposed reporting structure and the pros and cons ; Who: NGG ; By: next working group*
- *Action: Provide baseline for SO costs, what drives these costs and what is currently being delivered, then justify the proposed changes in costs from baseline ; Who: NGG ; By: next working group*
- *Action: Provide feedback on the principles of what makes a good cost driver. Propose a set of cost drivers that should be considered as part of the cost assessment process. ; Who: NGG ; By: February working group*
- *Action: NGG to provide details on what cost assessment they propose to undertake for the business plan submission ; Who: NGG ; By: next working group*
- *Action: present the three models for investment (SO, TO, Customer driven) with examples from RIIO-1, specifically Feeder 9 and IED ; Who: NGG ; By: 19/12/18*

Ofgem

- *Action: Ofgem to consider other RIIO sectors reporting and any issues which may arise from changing reporting categories ; Who: Ofgem ; By: next working group*
- *Action: articulate the difference between innovation, options assessment and ongoing efficiency ; Who: Ofgem ; By: next working group*

- *Action: write down the questions to be answered by CBA, develop templates and be consistent cross sector | Who: Ofgem | By: next working group*

NGG & Ofgem

- *Action: Take offline and define asset categories reporting and cost definitions and drivers for investment, understand what is in scope for particular investments and where the boundary is, what is exceptional and what needs to change | Who: NGGT and Ofgem via bilaterals | By: feedback on progress at the next working group*
- *Action: provide update on cost assessment approach at next WG | Who: NGG & Ofgem | By: next working group*
- *Action: agree the key principles for business plans data template development | Who: Ofgem & NGG | By: next working group*
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- *Action: provide clarity on approach to defining capability and flexibility | Who: NGG & Ofgem | By: 30/11/18*

8. Next Steps

Next Cost Assessment Working Group to be arranged for the end January 2019.