Minutes

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for energy consumers

Cost Assessment Working Group – Meeting 7		
From: Ofgem	Date: 13th March 2019 Time: 10:00am – 3:30pm	Location: Ofgem, London

1. Overview of models, unit cost analysis and proposed focus areas

1.1. This presentation highlighted how regressions and quality (ie performance against outputs) should be considered together. The group discussed how it is difficult to incorporate quality into regressions, but there was a consensus that looking at quality alongside the model results provides an important sense check. It was discussed that linking specific outputs to each of the models is very difficult, so a totex view may be more appropriate. One stakeholder raised the point that in RIIO-GD1, one specific adjustment was made in relation to quality, where a GDN was setting the benchmark for emergency costs, but failing to meet emergency standards. Ofgem identified quality as an area that they need to explore further and discuss with other sectors.

2. Opex regression models

Modern Equivalent Asset Value (MEAV)

2.1. There was a discussion on how in RIIO-GD1, the pressure reduction assets (Offtakes, Pressure Reduction Stations and District governors) were adjusted for size by using the average throughput from a certain period for each of the assets. One stakeholder suggested that the throughput doesn't reflect the asset size because some large, older assets have a throughput much below their capacity. Another stakeholder argued that although the maintenance costs of these larger assets would be high, replacement costs would be lower as they would be replaced by smaller assets to match the low throughput.

2.2. There was general agreement that MEAV would need updating in several ways for RIIO-GD2: to reflect more recent asset values than the RIIO-GD1 assigned costs; to use the updated diameter band splits; and using newly determined throughput data. There was also some discussion on potential additional aspects that could be included in MEAV for RIIO-GD2 if it is used as a driver. For example, biomethane embedded entry points, which are adopted and maintained by GDNs. In addition, it was suggested that multiply occupancy buildings (MOBs) should be included in MEAV if the data is consistently reported, noting that it was of significant value and that the data was much improved recently.

2.3. Ofgem presented their analysis on alternative scale drivers to MEAV: customer numbers, network length and throughput, noting that MEAV represents all three of these alternative drivers. Therefore, the similarity in the regression results using these alternative drivers indicates that MEAV does what it is intended to do. One stakeholder suggested that these individual drivers will each favour a different network slightly, so using MEAV which considers all of these drivers could reduce this impact.

2.4. The group talked about the consistency issues around customer numbers, and how this limits its use as an alternative to MEAV. However, it was suggested that Ofgem could take the customer numbers directly from Xoserve to ensure consistent reporting of this data.

Work Management

2.5. NGN weren't present at the meeting, but the presentation slides had been circulated in advance and were still discussed by the group.

2.6. The work management presentation suggested that the majority of the operations management costs are driven by emergency, repair and maintenance. It was suggested that the operations management costs could either be split out into individual direct activities, or a CSV driver could be created based on the drivers for

emergency and repair, maintenance, and MEAV for the residual. There was general agreement among the group that the operations management costs are driven largely by the drivers for these direct activities. However, it was raised that there are inconsistencies between networks (eg how they structure their staff) which make it difficult to allocate these costs consistently to the direct activities.

2.7. The group discussed the possibility of allocating the customer management costs to the emergency and repair regression. There was disagreement here, with most stakeholders suggesting that the customer management costs would need to be spread across a number of areas, not just to emergency and repair.

2.8. One stakeholder suggested a totex view is more useful for system control and asset management due to structural differences between GDNs. There was also some uncertainty and disagreement in what drives the costs in this area.

2.9. There was a general group consensus that the work management costs aren't material enough to justify this level of disaggregation which would be complicated and could introduce additional inconsistencies, which would be very difficult to correct for historical data in particular.

Emergency and Repair

2.10. The use of publically reported escapes (PREs) was investigated as an alternative driver to customer numbers. It was highlighted by one stakeholder that PREs weren't used as a driver in RIIO-GD1 due to their variability/volatility over time. Another stakeholder brought up their idea mentioned at a previous working group; to look at using maximum PREs over a time period, eg five years. One stakeholder suggested that the trend in PREs could change in the future, and that the trend might be linked with economic conditions, as people invest less or more in new boilers under different economic conditions.

2.11. There was a discussion on the use of repairs or reports as a driver for the repair regression. The group agreed that using the number of repairs does have a logic, ,

but that the number of reports is recorded more consistently and less under GDN control, so is better suited to be used as the cost driver.

2.12. The presentation suggested that there may be link between standards achieved (gas escapes prevented within 12 hours) and costs that aren't captured in the RIIO-GD1 model. One stakeholder suggested that the different targets set for the GDNs in RIIO-GD1 may be leading to differences in costs as the targets vary in how challenging they are.

2.13. Another conclusion in the presentation was to explore the use of synthetic unit costs for repairs. One stakeholder suggested that this could be done by multiplying the reports by the proportion of repairs in each diameter band to get the number of reports by diameter band. This would be multiplied by synthetic unit costs based for example on the repair time taken for repairs by diameter band (repairs on larger diameter bands taking far longer than small). . It was highlighted that there is a high concentration of larger diameter bands in London, and that there aren't any regional factors that address this in terms of repairs in RIIO-GD1. This diameter band synthetic unit cost for repairs would incorporate the differences in mix of diameter band repair work between the GDNs into the model.

Maintenance

2.14. The group discussion on the maintenance presentation identified three separate issues in this cost area:

1. Lumpy nature of the maintenance costs
2. Opex/capex accounting differences
3. Opex/capex solutions (efficiency choice captured by totex)

2.15. Ofgem presented their regression results for maintenance using the MEAV cost driver with and without LTS. One stakeholder raised their view that LTS should remain in the MEAV because there are large costs associated with LTS. Another stakeholder

suggested that the proportion of LTS in the MEAV could be re-calculated to reflect the proportion of industry spend in this area.

3. Business Support

3.1. The presentation identified a number of possible options to try to overcome the differences in GDN structure, capitalisation and allocation of business support costs. There was considerable support from stakeholders for using the totex approach to overcome these issues. One stakeholder stated that it would be interesting to look at a few of the items with the largest costs in business support and compare the companies (eg overall costs, insource/outsource strategies etc).

4. Next Steps

4.1. There was some discussion on when and how regional factors and the indexation of real price effects will be discussed. Ofgem will update the group on timescales for engagement on these work streams when there is more clarity on this.

4.2. Stakeholders volunteered to each carry out some work on more of the regression topics ahead of the next CAWG. The provisional agenda is published online[1].

[1] https://www.ofgem.gov.uk/publications-and-updates/riio-gd2-working-groups