Making a positive difference
for energy consumers

Decarbonisation Working Group

16th April 2019

Agenda

1. Introductions (13:30-13:40)

- *Overview of what we wish to achieve from the meeting.*
- *Run through of action log*

2. Biomethane (13:40 – 14:20)

- *Connections process, guides and standardisation*

N/A as commercially sensitive.

David Hurren (13:40 – 14:00)

Open discussion (14:00 – 14:20)

3. Shrinkage (14:20-15:40)

- *Ofgem-led discussion.*

4. Any other business (15:40-16:00)

Shrinkage Incentive strawman

We consulted on 3 potential incentive options for shrinkage and leakage:

1. Retention of the status quo
2. A more targeted financial incentive only applying to shrinkage reductions not resulting from the core repex programme, with a cap and collar.
3. A reputational ODI linked to a clear target

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Stakeholders views.....

Ongoing policy development - for discussion only

- General agreement from GDNs that GD1 incentive had successfully driven improvements, but mixed opinions on whether keeping same structure would be appropriate for GD2.

- Other stakeholders emphasised need for strong message from us on all areas of environmental impact, noting importance of leakage to GDNs' BCF. Wanted to see carbon costs appropriately factored into network decision making.

- 2 DNOs noted strategic approach used for RIIO-ED1, backed by licence condition and detailed reporting, covering all areas of losses.

A strawman for shrinkage?

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Reflecting on consultation and responses, and our last stakeholder group, shrinkage in RIIO-GD2 could be broken down into three areas:

- A **financial** incentive for activities that:
  - Are within the GDNs' control
  - Can be influenced by the existence of such an incentive
  - Will have an impact on the volumes calculated through the Shrinkage & Leakage Model (SLM)

- A **reputational** incentive linked to an overall shrinkage target

- **Bespoke** incentives for any activities calculated on a fixed basis in the SLM but with alternative means of assessing shrinkage reductions.

Financial incentive options

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Could a financial incentive be based on **Pressure Management** and **MEG conditioning?**

- GDN analysis at the previous working group suggested that:
  - These are the main activities within GDNs' control (outside of repex)
  - They can have a meaningful impact on shrinkage levels
  - The impact of these can be calculated on an annual basis.

GDN leakage reduction split by component
(as presented by GDNs at February Working Group)

Shrinkage component	13-14	14-15	15-16	16-17	17-18
LP Mains Asset (Replacement)	(73.3)	(61.2)	(63.9)	(55.7)	(58.3)
Service Replacement	(26.9)	(32.7)	(27.2)	(28.2)	(24.9)
Pressure (ASP)	(40.1)	(33.6)	(11.8)	21.7	18.4
MEG	5.3	(0.5)	(3.3)	(6.4)	(1.8)
Other Leakage	6.5	(17.4)	20.7	(19.2)	(4.1)
Total	**(128.5)**	**(145.3)**	**(85.5)**	**(87.9)**	**(70.6)**

Is this a viable approach for a financial incentive?

Financial incentive considerations

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- A financial incentive could be appropriate:
  - To ensure that the carbon price is factored into any decisions on pressure/conditioning in network.
  - To ensure that gains achieved in RIIO-GD1 (guaranteed 8 years' worth of rewards based on the final year's result) are maintained going forward.

- Incentive could be based on comparative impact of pressure / MEG versus fixed target set at level of final year of RIIO-GD1 (i.e. individual for each GDN).

- No need for separate EEI and shrinkage incentive if these are the only activities with financial incentive. Value would be based on sum of carbon price and actual gas replacement costs.

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Avg. pressure financial incentive - workings

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	GD1 Year 8	GD2 Year 1	GD2 Year 2	GD2 Year 3	GD2 Year 4	GD2 Year 5
Total outturn shrinkage (GWh)	375	349	318	286	268	255
of which network leakage	300	279	254	229	214	204
Average outturn pressure (mbar)	32	30	28	28	32	34

Modelled network leakage at benchmark pressure (32mbar)	300	284	264	239	214	199
Pressure-related leakage reduction (GWh)	0	-5	-10	-10	0	5

Carbon cost per GWh (£000s)		72	74	76	78	80
Gas cost per GWh (£000s)		20	18	19	23	22
Incentive value per GWh (£000s)		**92**	**92**	**95**	**101**	**102**
Total incentive (£000s)		**460**	**920**	**950**	**0**	**-510**
					GD2 Total	**1820**

(Note that all numbers are purely indicative)

- Would this work in practice?
- Would the same approach work for MEG?

Repex approach

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Repex is the driver of enduring reductions in shrinkage.

- An incentive might encourage the acceleration of some of this work

But:

- This work will happen anyway as it's funded under the price control (and most of it also compulsory)
- It's extremely difficult for us to evidence/measure the benefits specifically driven by the incentives.
- Mandatory repex – Incentive may have helped prioritise work in the past, but scope for this reduces as we get closer to 2032.
- Non mandatory repex - CBA includes environmental benefits so carbon price-based incentive already built in when allowances are set.
- Restricting incentive to any particular area of repex could risk perverse incentives - encouraging GDNs to reduce work on other areas.

- Have we missed any key points in our understanding?
- If above is valid, does this point to a reputational incentive through annual reporting (see next slide)?

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2. Reputational incentive

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- GDNs could still develop targets for overall shrinkage.
  - Necessary in order to set shrinkage allowances.
  - Provides stakeholders with visibility of how repex-driven leakage reductions will progress over RIIO-GD2 – important given the contribution of shrinkage to a GDN's BCF.

- GDNs could put forward total shrinkage targets, divided between network leakage (i.e. from mains and services) and other shrinkage.

- Targets could be tested with stakeholders inc. CEG, with explanation of how these relate to repex plans.

- GDNs could report their performance against these targets on annual basis, with commentary:
  - To explain any under/over performance.
  - On other actions taken to reduce shrinkage (e.g. increased efficiencies with own use gas, reducing leakage at AGIs).

Would this approach make sense?

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- We could consider proposals for bespoke incentives related to activities not captured by the Shrinkage and Leakage Model (e.g. areas calculated as a fixed % of supply volume). These include:
  - AGIs
  - Interference
  - Own Use Gas
  - Theft

- We would expect any proposals to include robust means of assessing how they are contributing to shrinkage reductions.

- Do you think bespoke outputs in this area have a important role to play?
- Do you think the scope of areas where bespoke outputs may be appropriate is correct?

AOB

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