

Ofgem comments on the PN UNC workgroup costs and benefits information request

01.10.2012

Key messages

- The counterfactual is a key element of the impact assessment. We suggest making it more clear, and highlight it by including it in a separate section
- The document would benefit from the introduction of a section explaining the methodology that will be used to compare costs with benefits.
- It is key that data provided by different respondents are comparable. If this is not the case, the risk is that this data might not be able to be used for quantitative analysis in the impact assessment
- Comparability of data highlights the importance of being able to compare a given scenario across multiple respondents, or multiple scenarios for the same respondent
- The assessment of benefits, competition and distributional effects, impacts on consumers, and the role of the central agent should be as comprehensive as possible, even if it is being proposed to quantify only a limited number of these impacts
- Given the tight deadlines, a detailed project plan would be helpful to highlight risks and guide the work

Objective

This note sets out our comments to the workgroup initial draft on Project Nexus (PN) costs and benefits information request. These comments aim to provide clarity to the industry about the elements that we consider important to include when conducting this type of analysis. They should also provide clarity as to how Ofgem are going to assess whether the Impact Assessment delivered by the PN UNC workgroup is robust and enables us to make an informed decision on PN related modifications.

We hope this may be helpful to the PN UNC workgroup in designing their Impact Assessment. Notwithstanding, we note that it is for the workgroup to satisfy itself that the Impact Assessment is robust and sufficient to enable it and parties who wish to respond to the modification consultation to assess the impacts of the modifications.

In our comments, we assume that:

- The PN UNC workgroup is designing a robust methodology to assess qualitative and quantitatively the impacts of PN related modifications
- On a high level, this methodology consists in quantifying, wherever possible, all the costs related with the project, and one single benefit
- Based on this methodology, there will be a consultation process where interested parties will provide comments on the methodology and costs and benefits data
- The quality of the data collected will be audited
- The data will be used to inform the Impact Assessment. This will be delivered together with PN modifications to enable Ofgem to take a decision by April 2013

Comments

- 1) Introduction and counterfactual
 - a. It is important that the purpose of the analysis, and the basis for collecting costs and benefits, is very clear. Given that the modifications on PN have now been raised, we suggest that the introduction makes clear to which modification(s) the costs and benefits refer to (and provide links to the documents).
 - b. If the purpose is for the analysis to cover more than one modification, we suggest compiling the data and conducting the analysis independently for each modification, and for the analysis to capture the net impact of the individual modifications
 - c. We suggest making clear that the counterfactual should not include any additional services in relation to the ones present today (at the date of publishing the request for information) in the UNC. (We also feel it is important that parties are very clear about what the counterfactual is, and that probably this section would benefit if it was highlighted/included as a separate section).
- 2) Methodology to compare costs and benefits
 - a. The document does not seem to cover this element at present
 - b. It is important that all parties, including the ones that will have to provide the data, are aware of the methodology to compare the costs with the benefits. We suggest that this methodology is set at the outset (for example, will costs and benefits be modelled over a set period of time?)
- 3) Methodology to calculate costs
 - a. Our understanding is that, in designing the methodology for assessing costs,
 - i. The workgroup will consider 3 scenarios
 - ii. Each individual respondent will explain and provide data based on what each scenario represents to its individual organisation
 - iii. Two types of costs – one-off and operational – are considered. Each includes some breakdown into cost categories
 - iv. Shipper and transporter costs are sought. Transporters include both distribution and transmission operators
 - b. We consider that the methodology would benefit from additional clarification (for example, the document does not set out an explanation of what each cost category represents. We suggest
 - i. Any subsequent auditing the data and ensuring that it is comparable may be accomplished either via a narrative provided by respondents, a more detailed breakdown of cost categories, more information on what should be included in the cost categories, or a mix of both. We suggest the latter. Very high level costs categories will allow space for subjectivity and make it more difficult to conduct the auditing process, and may block the aim of comparing the data. We suggest a more detailed breakdown of cost categories, complemented by the explanation of the data provided. For example, what does internal processes represent, and can it be breakdown into further categories? What do administration costs represent? Do they represent process costs? Are there any ongoing system costs? Can systems costs be split into hardware and software, development and maintenance?

- ii. Irrespective of which cost categories are identified, we suggest that a brief description of each is provided, if possible including examples. Where specific cost categories could benefit from a common methodology, we suggest this is discussed and set out in the document
 - iii. In relation to the scenarios, it is important that for respondents to be clear what each scenario represents. To enable data to be comparable, we suggest making pre-defined the characteristics of each scenario. As the reason for building each scenarios is to capture the impacts of different cost/benefits drivers, we suggest that the characteristics as a minimum should include:
 - 1. Level of usage of individual settlement products
 - 2. Frequency of submission of meter reads for settlements products 3 and 4
 - iv. We encourage the workgroup to identify other possible characteristics/cost drivers, inclusive in relation to the modifications related to the supply point register, retrospective updates, invoicing, and non-functional requirements. We suggest then to include in the PN information request all the characteristics that have been identified.
 - v. In responding to the PN Information Request, for each scenario, respondents should indicate what are their assumptions on each of these characteristics, and provide some narrative explaining their choice of assumptions
 - vi. We suggest also that respondents are asked to indicate whether they are not able to quantify certain costs. We encourage the workgroup to discuss and identify these costs in advance of publishing the PN information request. To the extent that it is not possible to quantify these costs, the PN information request should be clear at the outset about the approach to the qualitative assessment of costs. This should include
 - 1. The effect of the cost
 - 2. How sensitive it is to the scenarios (i.e. are these costs likely to change according to each scenario)
 - 3. Links to the quantitative assessment (if possible)
- 4) Methodology to calculate benefits
- a. Our understanding is that the workgroup will quantify one single benefit. The workgroup expectation is that this benefit will be higher than the total costs. Xoserve is conducting work to quantify this benefit.
 - b. We understand that quantifying this benefit involves two steps
 - i. Xoserve quantification of a distributional effect
 - ii. Further quantification of how this effect translates into a net benefit to the industry/consumers – using a methodology proposed by one shipper
 - c. We suggest that both these methodologies are included in the document the soonest possible. We note that it should be possible (and in our view desirable) to include the methodology in the document even if the actual quantification of the benefit(s) will take longer to be estimated

- d. We would like to understand what process will be used to identify additional benefits should the quantification of this single benefit be insufficient to match the level of costs. We would also suggest that this is captured in the project plan
 - e. We also suggest that the PN Information Request identifies and sets out the approach to the qualitative assessment of benefits, including
 - i. The identification of the benefits that are not possible to quantify
 - ii. Its effects
 - iii. How sensitive it is to the scenarios
 - iv. Links to quantitative assessment (if possible)
- 5) Impacts on competition and distributional effects
- a. The PN information request could do more to assess the competition impacts and the distributional effects. We suggest that the PN information request sets out the approach to assess competitive effects and the distribution of benefits and costs (eg portfolio impacts and impacts on tariff offers, impacts in different segments of the industry (NDM, DM, SSP, LSP))
- 6) Impacts on consumers
- a. We suggest that the final impact assessment should include an assessment of how the identified costs and benefits are likely to impact on consumers (note that these may be may be more than an explicit financial amount on the bill).
- 7) Central agent
- a. The impacts on the central agent seem to be considered very lightly at the moment, with the only reference being to a potential cost of £20m in implementing new systems
 - b. We suggest that the central agent impacts are considered in more detail in the document. This would include
 - i. The quantification and related explanation of the incremental investment for delivering PN modification(s)
 - ii. The identification of any other costs and benefits that the central agent may face, either one-off or ongoing
- 8) Project plan
- a. At the moment the detailed project plan to deliver this impact assessment remains unclear to us (for example, when will the auditing and analysis stages be undertaken). We anticipate that this will be part of the project plan that transporters will deliver in mid- October, as per the response letter to Ofgem.