

## Cost Assessment Working Group – Meeting 14

From: Ofgem

Date: 1<sup>st</sup> May 2020

Time: 10:00 – 12:00

Location: Teleconference

### 1. Present

Ofgem  
Cadent  
NGN  
SGN  
WWU

### 2. Econometric Modelling Results

- 2.1. Ofgem presented its preliminary econometric modelling results across four different time periods: (1) Historical data (2013/14 to 2018/19), (2) RIIO-GD1+RIIO-GD2 data, (3) RIIO-GD1 data and (4) RIIO-GD2 data. Ofgem reminded the group that the modelling work is still ongoing and thus results are subject to change.
- 2.2. Ofgem noted the performance of the Work Management (opex) and Reinforcement (capex) regressions was poor relative to the other bottom-up regressions and the totex regression. The performance of the Work Management regression improved under the RIIO-GD2 data scenario, however the Reinforcement regression worsened.
- 2.3. One stakeholder noted the number of regressions that failed the RESET test, and questioned Ofgem's position on this. Ofgem confirmed that these would be tested under an alternative model specification (for example, with a quadratic term), and if model performance did not improve, the original specification could be used.
- 2.4. One stakeholder suggested that Ofgem share the underlying data for the Work Management and Reinforcement regressions, for comparison with their own analysis, to determine reasons behind any differences in results.

- 2.5. Ofgem confirmed that under alternative cost pools, such as opex plus, the poor performance of the Reinforcement regression would remain an issue to resolve, unless it was to be assessed via a non-regression method.

### **3. Model selection: Time period**

- 3.1. Ofgem presented totex and bottom-up model performance over the different time periods, noting differences in model fit, performance against the RESET test and the range observed in efficiency scores. Ofgem also commented on the consistency of company rankings over time. One stakeholder noted that the approach to smoothing Reinforcement capex could have some impact on the annual sensitivity of rankings.
- 3.2. One stakeholder highlighted the importance of including forecast RIIO-GD1 years in the model. They explained that the RIIO-GD1 forecasts are often underpinned by existing contracts, making them reliable forecasts. They added that increases in wage settlements over the RIIO-GD1 period may be picked up in the RIIO-GD1 forecast years, but not the historical years.
- 3.3. One stakeholder asked if Ofgem plan to account for the fact that forecasts were made before the Covid-19 emergency. Ofgem confirmed that the Draft Determinations will be based on the submitted Business Plan data. It was also noted that Ofgem is still reviewing how best to deal with the Covid-19 impact on the remaining years of RIIO-1 and into RIIO-2, but that this will be considered separately.

### **4. Model selection: Model aggregation**

- 4.1. Ofgem presented a high level summary of the strengths and weaknesses of top-down and bottom-up modelling approaches. One stakeholder noted that given the lower R-squared values observed for the bottom-up models, it wasn't necessarily true that these models demonstrated a stronger relationship between costs and cost drivers. Ofgem noted that the bottom-up modelling results were subject to change based on further data adjustments.

4.2. One stakeholder commented that no single approach was likely to be perfect, and this has been the reason for selecting multiple approaches in the past. However, some may be better than others. Several stakeholders stated that the weighting of top-down and bottom-up models should reflect the confidence and robustness of the models. One stakeholder suggested that an alternative could be to go beyond disaggregated models by looking at the other top-down options considered. Another stakeholder warned against using models with only scale drivers given the substantial differences between GDNs.

## **5. Discussion: Modelling scenarios**

5.1. Ofgem presented an example of a model 'decision tree', which mapped the decisions for time period, number of models and weighting of models. The stakeholders largely agreed with the process illustrated, but commented that these decisions did not necessarily need to be made in this order. Ofgem agreed that the process is more iterative.

5.2. There was a discussion around the use of the totex CSV. One stakeholder noted that it is largely made up of the bottom-up regression components, however the additional weighting of MEAV in this CSV requires some further thought, in particular its impact on the overall model weighting decision.

## **6. AOB**

6.1. One stakeholder asked if the models will undergo external insurance. Ofgem stated that model assurance is being carried out both internally and by external consultants.

6.2. Another stakeholder asked whether any work on frontier shift will be shared before Draft Determinations. Ofgem replied that this is unlikely, although follow-up questions with the companies might be required.

6.3. Ofgem reiterated its intention to publish models at a fairly granular level, provided there are no confidentiality issues.