

## RIIO-ED2 Cost Assessment Working Group (CAWG) – 14th January 2020

From: Ofgem

Date: 14<sup>th</sup> January

Time: 10am to 4pm

Location:  
1.13 10 South Colonnade

### 1. Present

Ofgem  
UK Power Networks (UKPN)  
Western Power Distribution (WPD)  
Northern Powergrid (NPG)  
Scottish Power Energy Networks (SPEN)  
Electricity North West (ENWL)  
Scottish and Southern Energy Networks (SSEN)

### 2. Pathway to ED2

- 2.1. The pathway and high-level timelines for publishing key ED2 decisions were discussed. Ofgem acknowledged the amount of work that will need to be done leading up to the sector methodology. Through Working Groups (WGs), key themes/policy directions will be drawn out to put forward for consultation next year.
- 2.2. Stakeholders requested clarity around the proposed date for the Draft Business Plan submission (currently stated as Q2/3 2021), noting that having the submission of the Draft Business Plans at the end of July, would mean that it would be aligned with the annual regulatory submission, making it easier to have the data for 2020/21 consistent in both submissions.

### 3. Terms of Reference

- 3.1. Ofgem provided an overview of the Terms of Reference (ToR) and some of the priorities and objectives for the Cost Assessment Working Group (CAWG). One of the key areas discussed was the RIIO-ED1 approach, and the assessing of its fitness for purpose for RIIO-ED2, with stakeholder's keen to better understand the position within the other sectors, most notably Gas Distribution.
- 3.2. **Action: Network companies to provide comments on the Terms of Reference (ToR) by 28th January.**
- 3.3. Ofgem highlighted the interaction between the CAWG and the Regulatory Instructions and Guidance (RIGs) process and the ongoing RIGs Working Group (RIGWG).
- 3.4. WPD requested clarity on the relationship between cost assessment process, totex benchmarking, disaggregated benchmarking, and the Business Plan Incentive (BPI). Ofgem confirmed that there will be dedicated sessions for discussion of the interaction of cost assessment process and the BPI in upcoming CAWGs.

- 3.5. UKPN questioned the use of historical data in ED2 cost assessment, suggesting that it may be inappropriate to use DPCR5 data for areas that have been subject to significant efficiency gains, or for areas such as decarbonisation or vulnerable customers, where historical data may not be relevant, given the scope of the proposed new activities.
- 3.6. Several DNOs discussed the role of scenarios in ED2, requesting clarity on whether DNOs should be working against different scenarios, a common scenario, or independent scenarios. Stakeholders also requested clarity on the underlying principles for cost assessment in ED2, questioning how totex benchmarking, disaggregated totex modelling, NARMS, CBAs, engineering justification papers, role of expert view etc. all fit together.
- 3.7. **Action: Network companies to provide their view on the underlying principles for the CAWG i.e. how should Ofgem carry out cost assessment and how should the cost assessment process fit together, by 28th January.**
- 3.8. Several DNOs discussed the setting of allowances for future activities, specifically those that may be considered as DSO activities. DNOs questioned whether or not the structure of DSO activities would align with existing benchmarking and the way they have been consulting with their stakeholders.
- 3.9. UKPN to present on their modelling of totex following the re-running of historic models with updated data.

## 4. Experience and lessons from ED1, CAWG priorities

- 4.1. Ofgem provided an overview of the experience and lessons from ED1. In reviewing Ofgem's approach in ED1, DNOs argued against continuing the Smart Grid Adjustment into ED2. DNOs, while acknowledging that tracking innovative solutions is useful, suggested considering Smart Grid Adjustment within ongoing efficiencies and real price effects (RPEs) stating the difficulties that they have had with the current approach and the benchmarking of 'non-costs'.
- 4.2. Ofgem suggested requesting DNOs to trial forecasts in this year's annual submission. WPD challenged this, arguing that the rules will not have been defined in advance, and that there would be more value in re-running some existing models. Other DNOs challenged the purpose of an early trial of forecasting, questioning whether this was to ensure the tables were fit for purpose and the guidance was clear, or whether it was to gauge the size of ED2 relative to ED1.
- 4.3. Several DNOs also challenged the value in generating a common scenario, and questioned how useful this exercise had been in other sectors, specifically Gas Distribution. Ofgem noted that colleagues from Gas Distribution, and other sectors, cost assessment teams will be brought in to discuss specific areas within this CAWG.
- 4.4. Ofgem noted that significant work had been completed in the RIGs to inform the BPDts in ED1. This year's RIGs changes will form the basis of which to develop the BPDt guidance for ED2.
- 4.5. Ofgem noted feedback from stakeholders that detailed benchmarking and regressions caused confusion. One of the challenges for ED2 is to identify areas where we can

make cost assessment process more digestible and easier to understand, while maintaining the integrity of the assessment.

- 4.6. Several DNOs claimed that ED1 is not compatible with Net-Zero ambitions. ENWL provided an example highlighting issues with incremental costs, where it may make sense to replace an existing asset with a more costly, higher rated asset. There would be Net-Zero benefits in future proofing the asset i.e. touching the asset once, and improvements in losses, but ENWL suggested that through Ofgem's cost assessment approach in ED1, they would not have been given the allowance for this.

## 5. CAWG workstream and ED1 approach

- 5.1. Ofgem provided an overview of the potential workstreams and common issues to be covered through the CAWG.
- 5.2. Various stakeholders discussed workforce resilience, commenting that this was an area that companies were not on average underspending their allowances on, and whether it could be considered as a sub set under Uncertainty Mechanisms. Various stakeholders also argued that one of the common issues, Uncertainty Mechanisms & Future Costs, should be split and considered as two separate issues.
- 5.3. Ofgem discussed bringing colleagues along from the Gas and Electricity Transmission sectors to future CAWGs to discuss their approach to some of the specific issues, such as RPEs for example.
- 5.4. **Action: ENWL to prepare an initial view of the proposed priorities for the CAWG, as per the SPEN/SEN suggestions for the OAWG, and circulate to all network companies by 28th January. Network companies to provide comments and feedback to ENWL on the proposed priorities by 3rd February for submission to Ofgem by 5th February.**
- 5.5. Several DNOs discussed the role of CBAs in ED2, commenting on the work that is currently being carried out by different DNOs, and requesting clarity on the relationship between cost assessment, CBAs, and engineering justification papers.
- 5.6. Several DNOs also discussed the relationship between the cost assessment process and the Business Plan Incentive (BPI). Ofgem highlighted the link between cost assessment and the BPI, and noted that this would be a key area for discussion at future CAWGs.
- 5.7. Ofgem presented an overview of Network Operating Costs (NOCs) in ED1, providing some detail on the cost components, allowances as a percentage of totex and cost assessment methods used in ED1. Stakeholders requested this level of information for all other elements of totex.
- 5.8. **Action: Ofgem to provide network companies with a breakdown of all Totex, as per Slide 30 'Overview of NOCs categories' in the 'CAWG 1 14012020' slide pack, by 28th January.**

## **6. AOB**

- 6.1. The next meeting will take place on 11th February and it will be held in Glasgow.
- 6.2. Based on the prioritisation exercise, we will set out the anticipated topics to be covered at the upcoming meetings.