

RIIO-ED2 Cost Assessment Working Group (CAWG) – 11th February 2020

From: Ofgem

Date: 11th February

Time: 10am to 4pm

Location:
Glasgow

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)
Frontier Economics

2. Terms of Reference

- 2.1. The Terms of Reference (ToR) for the CAWG and comments received from DNOs on the ToR were not discussed. These will be discussed at the next meeting on the 25th of February.

3. Frontier Economics presentation on benchmarking principles

- 3.1. Frontier Economics gave a presentation on the principles to support good regulatory practice, including a review of why regulators perform benchmarking, the incentives associated with benchmarking and they four key components of benchmarking: cost; cost drivers; sample size; and technique. Noting that there is always going to be a fixed limit on the sample size.
- 3.2. The associated benefits of totex models and disaggregated totex models were discussed, with the strong incentive properties and simplicity around totex models highlighted. UKPN commented that the benchmarking process could be simplified for ED2, along with the business plan incentive (BPI). They also noted that disaggregated totex modelling was required for ED2.
- 3.3. WPD questioned how totex assessments would take into account the different situations facing the different DNOs, as a result of the enhanced engagement requirements, and the different stakeholder views, particularly around decarbonisation targets.
- 3.4. Frontier Economics revisited the RIIO handbook, and reviewed the set of principles developed by CEPA/Ofgem to highlight the progress made so far in RIIO, the future challenges, and some guiding principles. The key guiding principles flagged was that benchmarking should encourage a focus on overall long run efficiency.

- 3.5. Several DNOs discussed the difficulty in relating adjustments to allowances made as a result of totex (top-down) assessments and outputs associated Output Delivery Incentives (ODIs) and Price Control Deliverables (PCDs).

4. ENWL presentation on cost assessment priorities and work plan in RIIO-ED2

- 4.1. ENWL presented the priorities and workplan for the CAWG, including four proposed future workstreams:

- Cost/Assessment justification framework;
- Incentives and dealing with uncertainty;
- Regionality and macro factors; and
- Modelling.

- 4.2. SPEN commented on what was required for the summer consultation on the Sector Specific Methodology, noting that this should frame future workstreams. WPD added that the links to already specified principles in the ED2 Open Letter should be highlighted, as they should be made aware of decisions that may have already been made.

- 4.3. The group discussed potential forward options for the CAWG including:

- Option 1 – a sub-group structure to focus on key priority areas as per Overarching Working Group (OAWG).
- Option 2 – extending working CAWGs that would cover approximately two key topics per meeting.

- 4.4. DNOs highlighted a preference for Option 2 given that Option 1 was likely to result in too many meetings.

- 4.5. In relation to the proposed meeting schedule, NPg commented that a review of ED1 and a review of the BPI for ED2 was required much earlier in the process. ENWL commented that high priority items and the key principles should be bottomed out up front, with components of the cost assessment toolkit discussed further down in the meeting schedule.

- 4.6. Action: Frontier Economics to distribute NPg Cost Assessment flow diagram from ED1.**

- 4.7. Action: DNOs to agree on new timeline of discussion for CAWG.**

- 4.8. Action: DNOs to identify work streams where they can lead discussions / presentations.**

- 4.9. WPD requested clarity on what Ofgem required for the Sector Specific Methodology Consultation. UKPN commented on the value of understanding the Ofgem view on

existing ED1 totex and disaggregated models, noting that some commentary on Annual Reports suggests these views exist.

- 4.10. **Action: Ofgem to share spreadsheet detailing totex and disaggregated models from ED1. DNOs to RAG review.**
- 4.11. **Action: Ofgem to arrange for colleagues from GD sector to present on disaggregated modelling (CAWG-4).**
- 4.12. **Action: ENWL to review and circulate useful information on previous work on 'middle models' for ED1.**
- 4.13. **Action: WPD and ENWL to review and circulate useful information on Ofwat approaches.**

5. NPg review of all DNO views on key principles for cost assessment in RIIO-ED2

- 5.1. Several DNOs commented that stakeholder views, and ensuring stakeholder views are fed into business plans, did not seem to align with the current cost assessment approach for benchmarking, which is primarily focused on historic performance and costs. DNOs questioned where stakeholder views and feedback sat in the hierarchy of decision making, noting that there may be some tension between current Cost Assessment approaches and stakeholder views.
- 5.2. DNOs noted that this was one particular issue / principle that had to be understood prior to embarking on stakeholder engagement process.
- 5.3. **Action: CAWG to liaise with the OAWG on the four key issues discussed: (1) role of confidence assessments in ED2; (2) role of the BPI in ED2; (3) role of stakeholder views in cost assessment in ED2; and (4) role of future costs in cost assessment in ED2.**

6. NPg presentation reviewing the balance between totex and disaggregated models

- 6.1. NPg gave a presentation reviewing the balance between totex and disaggregated models in ED1. Their view was that Ofgem's ED1 disaggregated models cost energy consumers over £1billion, commenting on the decision to fast track WPDs business plan and the use of disaggregated models in the slow track settlement.
- 6.2. NPg continued by highlighting other areas of the ED1 settlement show that Ofgem has successfully used a simple model to set large cost allowances, such as debt allowances which are set using a simple sector-wide average.
- 6.3. Several DNOs challenged some of NPg's views around totex and disaggregated modelling.

7. Actions, Next steps, AOB

- 7.1. The next CAWG will be on 25th February in London.